

Financial statements and report of independent certified public accountants

**Department of Human Services, State of Hawaii**

Year ended June 30, 2006

Submitted by  
The Auditor  
State of Hawaii

August 24, 2007

The Auditor  
State of Hawaii

This is our report on the financial audit of the Department of Human Services of the State of Hawaii (DHS) as of and for the year ended June 30, 2006. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

### **OBJECTIVES OF THE AUDIT**

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the DHS's basic financial statements as of and for the year ended June 30, 2006, and to comply with the requirements of OMB Circular A-133. More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the DHS's basic financial statements.
2. To determine whether expenditures and other disbursements have been made and all revenues and other receipts to which the DHS is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and the federal government.
3. To determine whether the DHS has established sufficient controls to properly manage federal financial assistance programs and to comply with the applicable laws and regulations.
4. To determine whether the DHS has complied with the laws and regulations that may have a material effect on the basic financial statements and on its major federal financial assistance programs.

### **SCOPE OF THE AUDIT**

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the DHS for the year ended June 30, 2006.

### **ORGANIZATION OF THE REPORT**

This report is presented in six parts as follows:

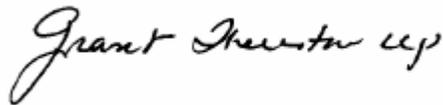
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- Part I – The basic financial statements and related notes of the DHS as of and for the year ended June 30, 2006, and our opinion on the basic financial statements.
- Part II – Our report on internal control over financial reporting and on compliance and other matters.
- Part III – Our report on compliance with requirements applicable to each major program and internal control over compliance.
- Part IV – Schedule of findings and questioned costs.
- Part V – The summary schedule of prior audit findings.
- Part VI – Response of the affected agency.

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the DHS.

Very truly yours,



Department of Human Services  
State of Hawaii

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**PART I**  
**FINANCIAL SECTION**

Report of Independent Certified Public Accountants

The Auditor  
State of Hawaii

We have audited the accompanying financial statements of the governmental activities and of each major fund of the Department of Human Services, State of Hawaii (DHS), as of and for the year ended June 30, 2006, which collectively comprise the DHS's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the DHS's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the DHS's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in note A, the financial statements of the DHS are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and of each major fund of the State of Hawaii that is attributable to the transactions of the DHS. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2006, and the changes in its financial position, for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and of each major fund of the DHS, as of June 30, 2006, the respective changes in financial position, and the respective budgetary comparison for the general and special revenue funds, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

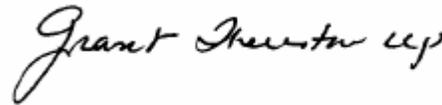
In accordance with *Governmental Auditing Standards*, we have also issued our report dated August 10, 2007, on our consideration of the DHS's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on

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compliance. That report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 9 through 19 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the DHS's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements of the DHS. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Honolulu, Hawaii  
August 10, 2007

Department of Human Services  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS  
(UNAUDITED)

June 30, 2006

This discussion and analysis of the financial performance of the Department of Human Services (DHS) provides an overview of the financial activities of the DHS for the year ended June 30, 2006. The intent of this discussion is to allow management to provide an objective and easily readable analysis of the financial activities of the DHS based on currently known facts, decisions, or conditions. Readers are encouraged to consider the information presented here in conjunction with the basic financial statements and other supplementary information.

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

This MD&A serves as an introduction to the basic financial statements of the DHS. The basic financial statements are comprised of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements.

#### ***Government-wide Financial Statements***

The government-wide financial statements provide a broad overview of the finances of the DHS using the economic resources measurement focus and accrual basis of accounting, in a manner similar to private-sector businesses. It provides both long-term and short-term information about the overall financial status of the DHS.

The statement of deficit in net assets includes all of the assets and liabilities of the DHS, with the difference between the two reported as net assets. This statement is similar to that of the balance sheet of a private-sector business. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the DHS is improving or deteriorating. This statement also provides information on how services were financed in the short-term as well as what remains for future spending.

The statement of activities presents information showing how net assets changed during the year. All changes in net assets are reported using the accrual method of accounting, similar to the method used by most private-sector businesses. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are reported when the goods or services are received, regardless of the timing of the related cash flows. The activities of the DHS are principally supported by appropriations made available by the State Legislature and intergovernmental revenues from the federal government (governmental activities). The DHS does not recover any portion of its costs through user fees or charges for services (business-type activities).

#### ***Fund Financial Statements***

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objects. The DHS uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the DHS are divided between either governmental funds or fiduciary funds. Governmental funds are used to account for most, if not all, of a government entity's tax-supported activities. Fiduciary funds are used to account for resources that are held by a government entity as a trustee or agent for parties outside of the government entity. The resources of fiduciary funds cannot be used to support the government entity's own programs.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2006

The fund financial statements of the DHS include the following types of funds:

**Governmental funds** – Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike government-wide financial statements, governmental fund financial statements focus on current sources and uses of spendable resources and balances of spendable resources available at the end of the year. Such information may be useful in evaluating a government entity's near-term financing requirements. By comparing the governmental fund and government-wide financial statements, readers may better understand the long-term impact of the entity's near-term financial decisions. In order to facilitate a comparison between the governmental fund and government-wide financial statements, a reconciliation between the two is provided following each governmental fund financial statement.

**Fiduciary funds** – The fiduciary funds of the DHS are used to account for resources held for the benefit of parties outside of the DHS. Fiduciary funds are excluded from the government-wide financial statements of the DHS because the DHS cannot use the resources of these funds to finance its operations.

***Notes to the Basic Financial Statements***

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2006

**FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The following table presents a condensed government-wide statement of deficit in net assets of the DHS as of June 30, 2006 and 2005.

**Condensed Statement of Deficit in Net Assets**

	2006	2005
Current assets	\$249,888,447	\$158,018,402
Capital assets, net	33,640,532	34,033,068
Total assets	\$283,528,979	\$192,051,470
Current liabilities	\$317,128,578	\$214,658,566
Non-current liabilities	9,786,264	9,615,461
Total liabilities	\$326,914,842	\$224,274,027
Deficit in net assets		
Invested in capital assets	\$ 33,640,532	\$ 34,033,068
Restricted	1,053,957	341,382
Unrestricted deficit	(78,080,352)	(66,597,007)
Total deficit in net assets	\$ (43,385,863)	\$ (32,222,557)

As noted earlier, an analysis of net assets over time may be a useful indicator of whether a government entity's financial condition is growing stronger or weakening. During the year ended June 30, 2006, the deficit in net assets of the DHS increased by approximately \$11.2 million.

The deficit in unrestricted net assets of the DHS was approximately \$78.1 million as of June 30, 2006. This deficit in unrestricted net assets is principally the result of liabilities for program services that were incurred as of June 30, 2006, for which state allotments are not yet available. The largest liability as of June 30, 2006, is the estimated amount of medical assistance service provided as of June 30, 2006, for which the related claims will be processed and paid subsequently. Of the estimated \$206.7 million of medical assistance payable, the state share of these costs is approximately \$85.1 million. The estimated federal share of these claims to be paid in the future was recorded as intergovernmental revenues in the current year and is included in the balance due from other governments. In addition to the estimated medical assistance payable, the liability for compensated absences totaling \$15.1 million as of June 30, 2006, is not funded by state allotments until the employee uses the earned leave or is paid out upon termination. Therefore, there are no assets currently available to the DHS to pay for these liabilities as of June 30, 2006.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2006

The DHS reported a total of approximately \$33.6 million in net assets invested in capital assets as of June 30, 2006. Although the DHS is not the legal owner of the state buildings that are reported as part of its capital assets, the portion of the state facilities used by the DHS are required to be reported as part of its capital assets. The DHS uses these capital assets to provide services; consequently, these assets are not available for future spending and the related annual depreciation expense of the cost of these facilities is included in the statement of activities for the year ended June 30, 2006.

The changes in the net assets of the DHS from governmental activities are summarized below. The DHS directs its resources towards assisting people to meet their basic needs for food, shelter, medical care and other essentials for daily living. As such, the DHS does not conduct business-type activities and the accompanying analysis of the changes in net assets focuses on the cost of services and who provides the funds to pay for the costs.

**Changes in Net Assets**

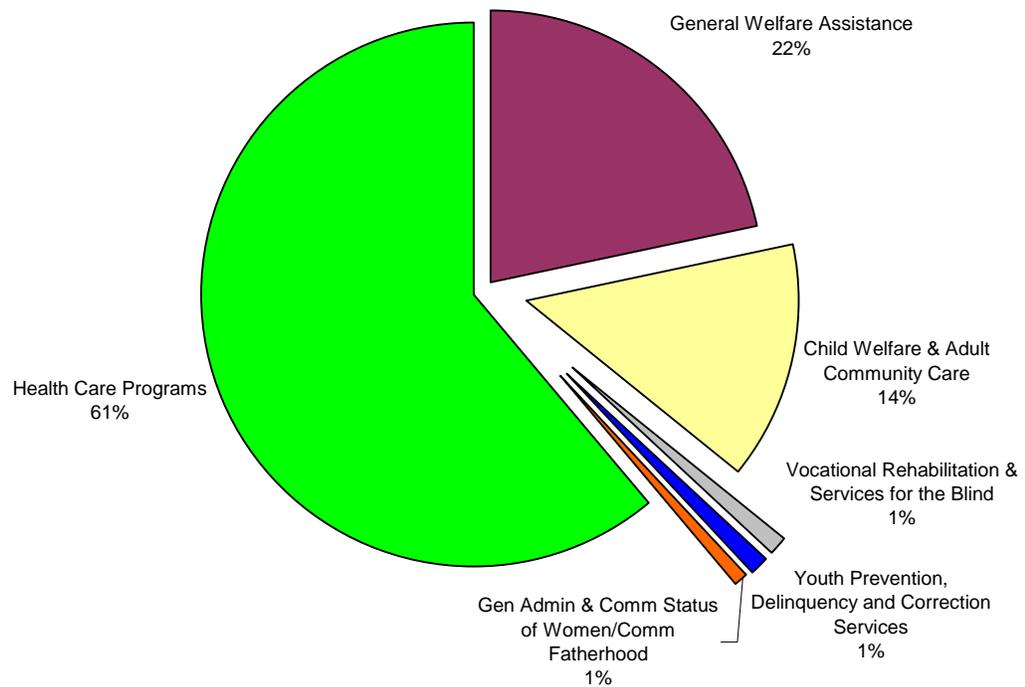
	2006	2005	Percent Change
Revenues			
Program revenues	\$1,101,767,450	\$ 994,809,130	10.75%
General revenues	623,851,583	650,320,174	(4.07)%
Total revenues	<u>1,725,619,033</u>	<u>1,645,129,304</u>	4.89%
Expenses			
Health care programs	1,062,635,792	979,995,269	8.43%
General welfare assistance, employment and support services	375,155,588	356,252,392	5.31%
Child welfare and adult community care services	246,120,226	264,254,276	(6.86)%
Vocational rehabilitation and services for the blind	22,812,703	23,451,840	(2.73)%
Youth prevention, delinquency and correction services	18,855,910	17,215,350	9.53%
General administration	11,073,922	10,876,052	1.82%
Commission on the status of women / commission on fatherhood	128,198	6,741	1801.77%
Total expenses	<u>1,736,782,339</u>	<u>1,652,051,920</u>	5.13%
Change in net assets	<u><u>\$ (11,163,306)</u></u>	<u><u>\$ (6,922,616)</u></u>	61.26%

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2006

The total cost of all programs and services was approximately \$1.74 billion, a 5.13% increase from the prior year. Health care and general welfare assistance programs comprised 61% and 22%, respectively, of the total costs. The following chart presents each major activity as a percent of the total cost of all DHS activities:



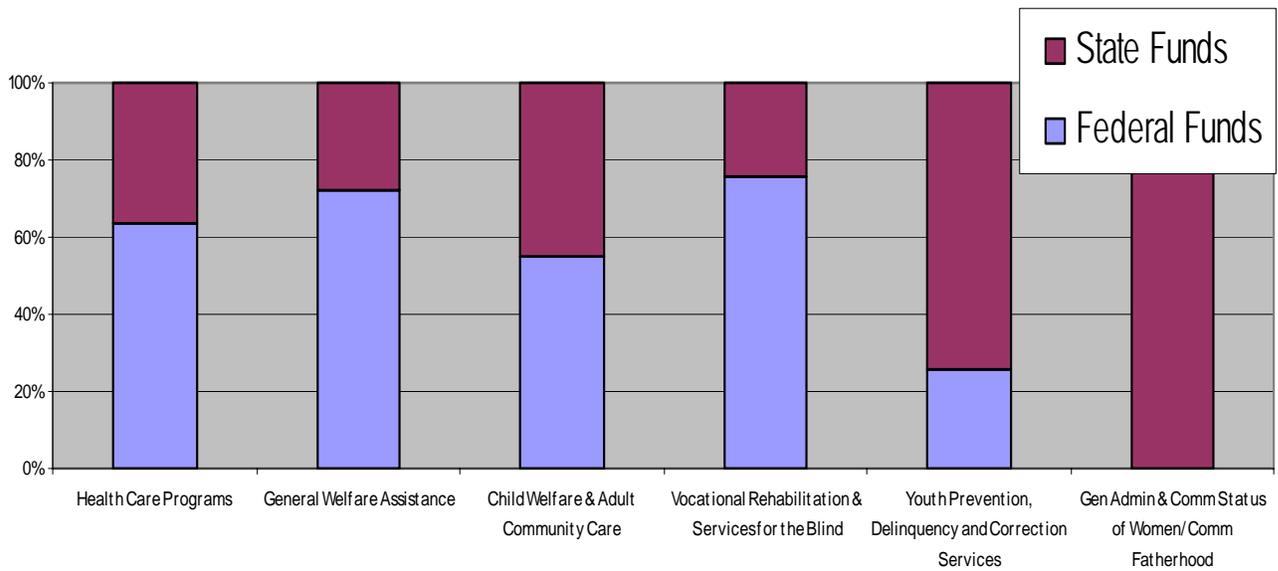
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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

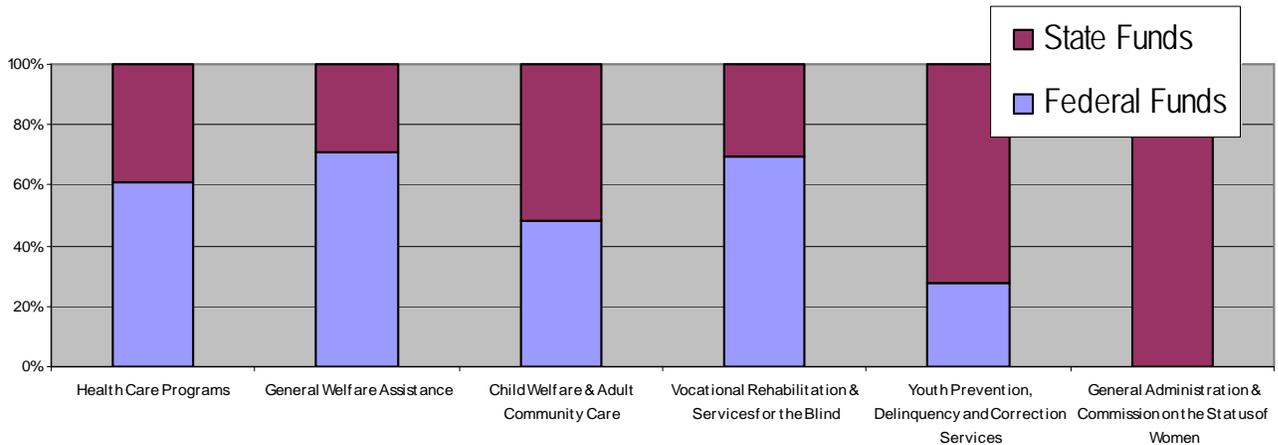
June 30, 2006

Program revenues consist primarily of operating grants from the federal government. Revenues from these federal grants paid for 63% of the cost of all the DHS's activities. The following chart presents the percentage of costs funded by federal grants for each major activity of the DHS for the years ended June 30, 2006 and 2005:

Year 2006:



Year 2005:



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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2006

**FINANCIAL ANALYSIS OF THE FUND FINANCIAL STATEMENTS**

As noted earlier, the DHS uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The DHS has two governmental fund types; the general fund and special revenue funds. The general fund is used to account for all financial resources except those required to be accounted for in another fund. The special revenue funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. In general, operating grants the DHS receives from the federal government are accounted for in the special revenue funds and all allotments of state funds are accounted for in the general fund along with any other resources available to the DHS that are not accounted for in the special revenue funds.

Total expenditures reported on a modified accrual basis increased by \$86.3 million over the prior year. This increase is primarily related to health care program costs administered by the DHS which have increased by approximately \$82.9 million or 8.47%. The increased costs in the health care program are principally due to an increase in recipients and medical assistance costs.

At June 30, 2006, the total governmental fund balance of the DHS consisted of a deficit in unreserved fund balance of approximately \$129.6 million. The deficit in the unreserved fund balance of the general fund totaling \$74.1 million is principally comprised of liabilities for program services that were incurred as of June 30, 2006, for which state allotments were not yet available. The deficit in the unreserved fund balance of the special revenue fund totaling \$55.5 million is principally the result of the encumbrances that were not liabilities as of June 30, 2006 and, therefore, the related intergovernmental revenues were not recorded.

Reservations of governmental fund balances for encumbrances totaled approximately \$68.1 million at June 30, 2006. Reservations of governmental fund balances indicate the amount of resources that are not available for new spending because it has been reserved to liquidate purchase and contractual commitments.

The following table presents total revenues and expenditures of the governmental funds of the DHS for the years ended June 30, 2006 and 2005:

	2006	2005	Percent Change
Revenues			
State allotted appropriations	\$ 602,803,032	\$ 633,024,995	(4.77)%
Intergovernmental revenues	1,101,767,450	991,677,216	11.10%
Non-imposed employee fringe benefits	21,048,551	17,295,179	21.70%
	<u>\$1,725,619,033</u>	<u>\$1,641,997,390</u>	5.09%

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2006

	2006	2005	Percent Change
Expenditures			
Health care programs	\$ 1,062,023,906	\$ 979,107,355	8.47%
General welfare assistance, employment and support services	374,921,535	356,024,138	5.31%
Child welfare and adult community care services	246,140,982	263,827,305	(6.70)%
Vocational rehabilitation and services for the blind	22,842,489	23,385,892	(2.32)%
Youth prevention, delinquency and correction services	18,704,262	16,471,553	13.55%
General administration	11,108,200	10,774,564	3.10%
Commission on the status of women / Commission on fatherhood	128,198	6,741	1801.77%
	<u>\$1,735,869,572</u>	<u>\$1,649,597,548</u>	5.23%

**BUDGETARY ANALYSIS**

As required by Section 37-68, Hawaii Revised Statutes, the DHS prepares a budget that becomes legally adopted when the State Legislature approves the executive budget with the enactment of an appropriations act. A comparison and analysis of the general fund is presented below as additional financial information:

	Original Budget	Final Budget	Actual on Budgetary Basis	Variance Favorable (Unfavorable)
Health care programs	\$410,381,408	\$409,485,822	\$402,341,249	\$ 7,144,573
General welfare assistance, employment and support services	115,476,976	109,244,194	107,834,124	1,410,070
Child welfare and adult community care services	140,111,400	141,331,486	109,661,870	31,669,616
Vocational rehabilitation and services for the blind	3,890,808	3,890,808	3,881,765	9,043
Youth prevention, delinquency and correction services	11,916,408	13,945,499	13,530,900	414,599
General administration	8,407,085	8,907,085	8,906,417	668
Commission on the status of women / Commission on fatherhood	100,158	100,158	94,933	5,225
	<u>\$690,284,243</u>	<u>\$686,905,052</u>	<u>\$646,251,258</u>	<u>\$40,653,794</u>

The change from the original to the final budgeted allotments for the General welfare assistance, employment and support services program was primarily due to a transfer of allotment to the Housing and Community Development

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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2006

Corporation of Hawaii's homeless program of \$5,175,000. Other differences between the original and final budget were due to intrafund transfers communicated through executive memorandums. Actual expenditures for the health care programs were \$ 7.1 million less than the amount budgeted due to an allotment not being decreased when Waimano Homes closed. Also, the actual expenditures for the child welfare and adult community care services programs were \$ 31.7 million less than the amount budgeted because the anticipated costs of claims for the Medicaid Waiver – Developmentally Disabled and Mentally Retarded clients were less than anticipated. Thus, the amounts expended in comparison to the amounts budgeted appear favorable.

**CAPITAL ASSETS**

As of June 30, 2006 and 2005, the cost basis of capital assets, net of accumulated depreciation, used by the DHS are presented in the table below. Approximately \$595,000 of capital assets were added in the year ended June 30, 2006. Annual depreciation totaling approximately \$2.2 million decreased the net cost basis during the year ended June 30, 2006.

**Capital Assets, Net of Depreciation**

	<u>2006</u>	<u>2005</u>
State office buildings and improvements	\$17,208,567	\$17,420,428
Buildings and improvements for the Office of Youth Services	<u>14,740,058</u>	<u>15,444,410</u>
Total buildings and improvements	31,948,625	32,864,838
Furniture, equipment and vehicles	1,691,901	1,168,224
Nondepreciable land	<u>6</u>	<u>6</u>
Total	<u>\$33,640,532</u>	<u>\$34,033,068</u>

In addition to the capital assets listed above, the DHS leases numerous office facilities from third-party lessors under operating lease arrangements. Those leases for additional space beyond the state facilities listed above as buildings and improvements are necessary to provide program services throughout the State.

**ECONOMIC FACTORS**

The DHS has three primary types of welfare assistance programs: (1) financial assistance in the form of cash benefits; (2) food stamp assistance that is also delivered in the form of cash benefits; and (3) medical assistance in the form of Medicaid fee-for-service coverage or managed care medical coverage under the Quest program. Individuals, couples and families may be eligible for one or all of these forms of assistance. However, eligibility for one program does not automatically make an individual/family eligible for other programs. The DHS tracks eligible individuals, couples or families as a single case (caseload).

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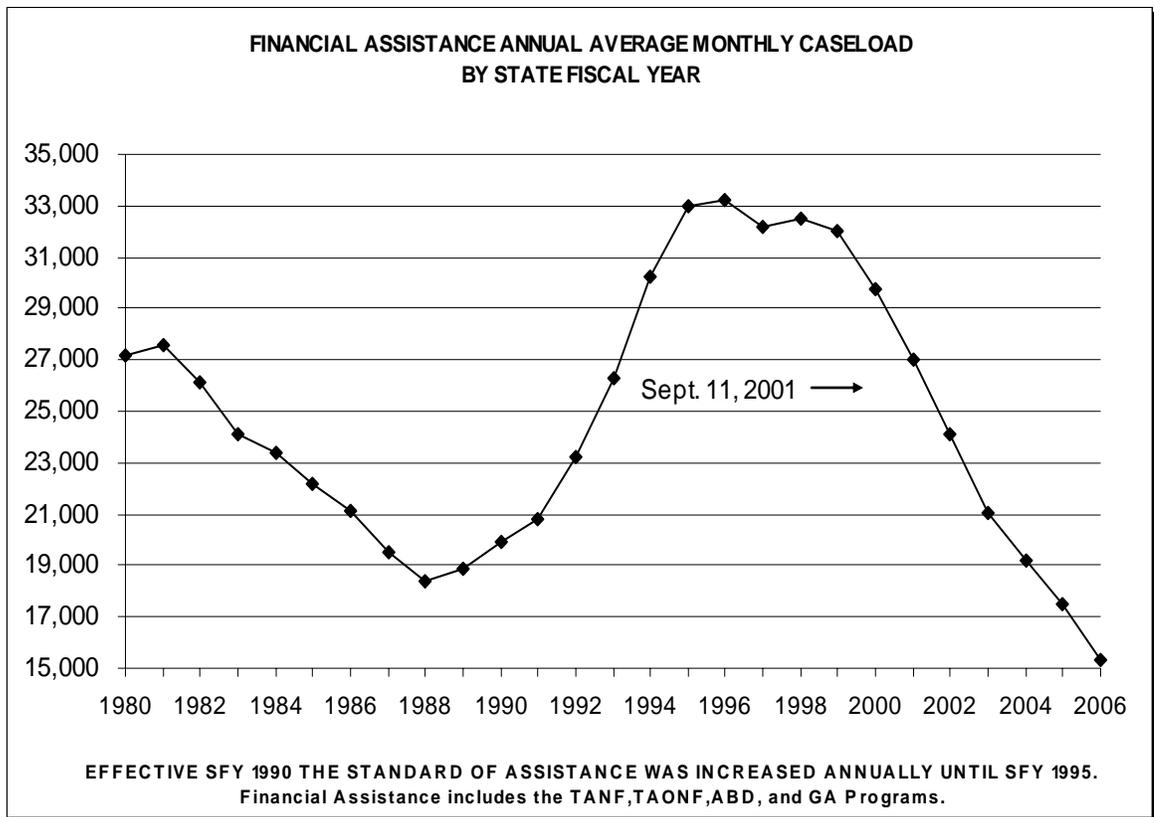
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2006

Five and one-half years after the events of September 11, 2001, individuals receiving financial assistance in Hawaii in family cases and in individual cases continued to decline from 65,444 individuals in September 2001 to 28,826 individuals in April 2007 or a decrease of 36,618 individuals or 56%. Much of this decline is due to the five-year limit on financial assistance benefits for family cases beginning in December 2001 as part of Hawaii's Welfare Reform Program (started in December 1996) but a large part of it can be attributed to the State's strong economy.

The number of individuals in Hawaii receiving Food Stamp benefits also declined since September 11, 2001 from 105,990 individuals in September 2001 to 88,171 individuals in April 2007. This is a decrease of 17,819 individuals or 16.8%. Part of this decline is attributed to the improving job market in Hawaii.

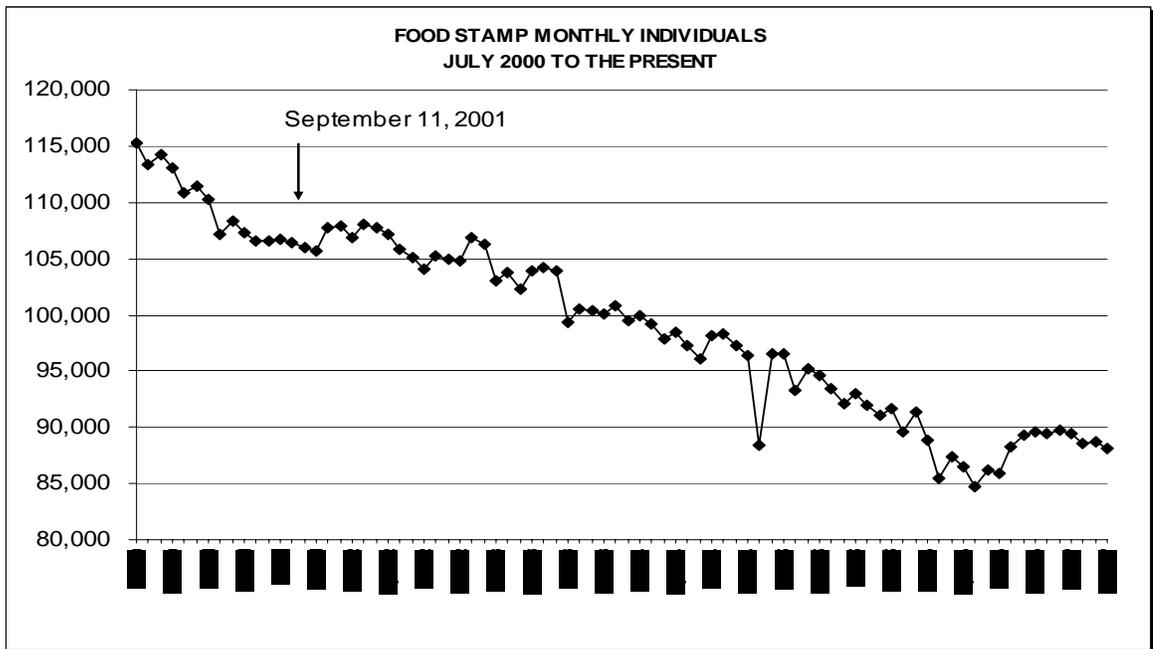
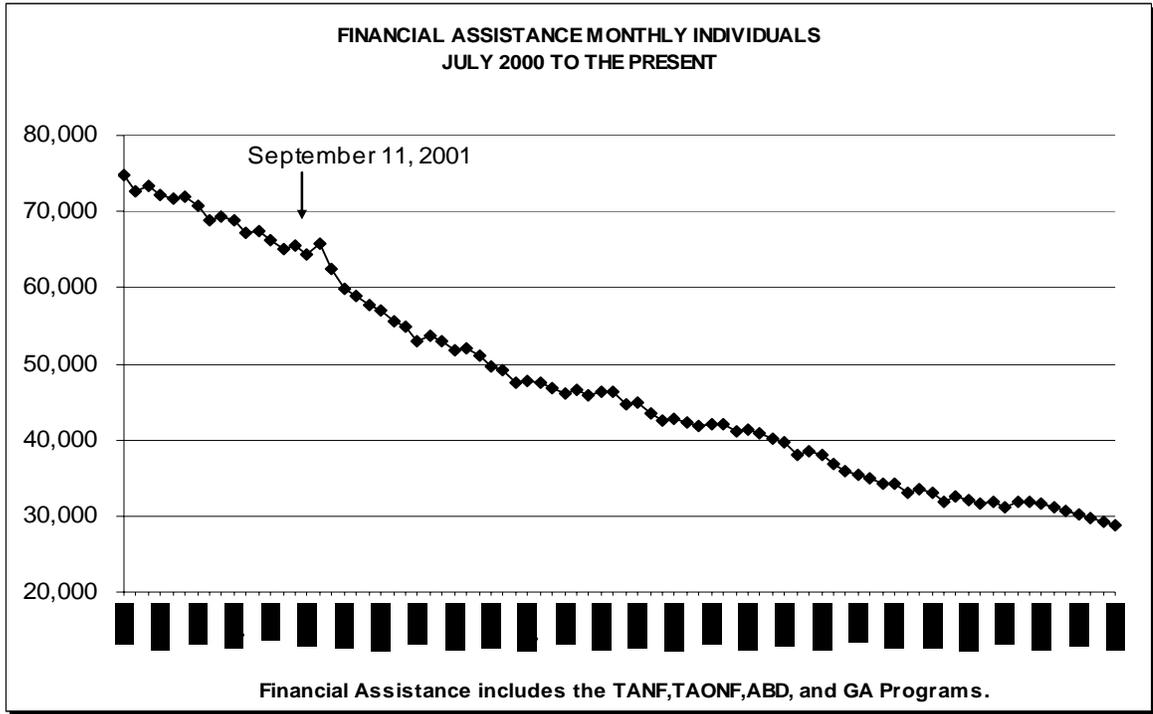
The following charts provide a trend analysis of currently known facts and conditions:



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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2006



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STATEMENT OF DEFICIT IN NET ASSETS

June 30, 2006

ASSETS	<u>Governmental Activities</u>
<b>CURRENT ASSETS</b>	
Cash	\$ 64,956,243
Receivables	3,637,854
Due from other State agency	200,000
Due from other governments	<u>181,094,350</u>
Total current assets	249,888,447
CAPITAL ASSETS, net of accumulated depreciation	<u>33,640,532</u>
Total assets	<u><u>\$ 283,528,979</u></u>
<b>LIABILITIES AND DEFICIT IN NET ASSETS</b>	
<b>CURRENT LIABILITIES</b>	
Vouchers payable	\$ 11,290,267
Accrued wages and employee benefits payable	7,451,848
Due to State of Hawaii	57,444,612
Due to other State agency	28,636,685
Accrued medical assistance payable	206,660,000
Accrued compensated absences	5,343,000
Workers' compensation liability	<u>302,166</u>
Total current liabilities	317,128,578
ACCRUED COMPENSATED ABSENCES, less current portion	<u>9,786,264</u>
Total liabilities	326,914,842
<b>DEFICIT IN NET ASSETS</b>	
Invested in capital assets	33,640,532
Restricted	1,053,957
Unrestricted deficit	<u>(78,080,352)</u>
Total deficit in net assets	<u>(43,385,863)</u>
Total liabilities and deficit in net assets	<u><u>\$ 283,528,979</u></u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF ACTIVITIES

Year ended June 30, 2006

Functions/Programs	Expenses	Program revenues		Governmental Activities	Net Expense and Changes in Deficit in Net Assets
		Charges for Services	Operating Grants and Contributions		
Governmental activities:					
Health care programs	\$ 1,062,635,792	\$ -	\$ 672,035,640	\$ -	\$ (390,600,152)
General welfare assistance, employment and support services	375,155,588	-	271,048,776	-	(104,106,812)
Child welfare and adult community care services	246,120,226	-	135,854,517	-	(110,265,709)
Vocational rehabilitation and services for the blind	22,812,703	-	17,335,238	-	(5,477,465)
Youth prevention, delinquency and correction services	18,855,910	-	5,458,804	-	(13,397,106)
General administration	11,073,922	-	-	-	(11,073,922)
Commission on the status of women / Commission on fatherhood	128,198	-	34,475	-	(93,723)
Total	<u>\$ 1,736,782,339</u>	<u>\$ -</u>	<u>\$1,101,767,450</u>	<u>\$ -</u>	(635,014,889)
General revenues:					
State allotments					602,803,032
State-provided payroll fringe benefits					21,048,551
Total general revenues					<u>623,851,583</u>
CHANGE IN NET ASSETS					(11,163,306)
Deficit in net assets at July 1, 2005					<u>(32,222,557)</u>
Deficit in net assets at June 30, 2006					<u>\$ (43,385,863)</u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2006

ASSETS	General	Special Revenue	Total
Cash	\$ 27,920,467	\$ 37,035,776	\$ 64,956,243
Receivables	2,356,508	1,281,346	3,637,854
Due from other funds	55,407,529	-	55,407,529
Due from State of Hawaii	-	24,234	24,234
Due from other State agencies	4,466,500	-	4,466,500
Due from other governments	-	181,094,350	181,094,350
Total assets	\$ 90,151,004	\$219,435,706	\$309,586,710
LIABILITIES AND FUND BALANCES			
LIABILITIES			
Vouchers payable	\$ 6,667,927	\$ 4,622,340	\$ 11,290,267
Accrued wages and employee benefits payable	3,603,153	3,848,695	7,451,848
Due to other funds	-	55,407,529	55,407,529
Due to State of Hawaii	57,468,846	-	57,468,846
Due to other State agency	-	32,903,185	32,903,185
Accrued medical assistance payable	85,060,000	121,600,000	206,660,000
Total liabilities	152,799,926	218,381,749	371,181,675
FUND BALANCES			
Reserved for encumbrances	11,463,844	56,588,266	68,052,110
Unreserved	(74,112,766)	(55,534,309)	(129,647,075)
Total fund balances (deficit)	(62,648,922)	1,053,957	(61,594,965)
Total liabilities and fund balances	\$ 90,151,004	\$219,435,706	\$309,586,710

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET  
TO THE STATEMENT OF DEFICIT IN NET ASSETS

June 30, 2006

Total deficit in fund balances - governmental funds			\$ (61,594,965)
Amounts reported for governmental activities in the statement of net assets are different because:			
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.			
Governmental capital assets	\$ 54,291,497		
Less accumulated depreciation	<u>(20,650,965)</u>	33,640,532	
Accrued compensated absences reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds			
			(15,129,264)
Workers' compensation liability reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds			
			<u>(302,166)</u>
Deficit in net assets of governmental activities			<u><u>\$ (43,385,863)</u></u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN  
FUND BALANCES - GOVERNMENTAL FUNDS

Year ended June 30, 2006

	General	Special Revenue	Total
Revenues			
State allotted appropriations	\$ 602,803,032	\$ -	\$ 602,803,032
Intergovernmental revenues	-	1,101,767,450	1,101,767,450
Non-imposed employee fringe benefits	21,048,551	-	21,048,551
	623,851,583	1,101,767,450	1,725,619,033
Expenditures			
Health care programs	389,988,266	672,035,640	1,062,023,906
General welfare assistance, employment and support services	103,919,977	271,001,558	374,921,535
Child welfare and adult community care services	110,421,289	135,719,693	246,140,982
Vocational rehabilitation and services for the blind	5,516,439	17,326,050	22,842,489
Youth prevention, delinquency and correction services	13,750,913	4,953,349	18,704,262
General administration	11,108,200	-	11,108,200
Commission on the status of women / Commission on fatherhood	109,613	18,585	128,198
	634,814,697	1,101,054,875	1,735,869,572
NET CHANGE IN FUND BALANCES	(10,963,114)	712,575	(10,250,539)
Fund balances (deficit) at July 1, 2005	(51,685,808)	341,382	(51,344,426)
Fund balances (deficit) at June 30, 2006	\$ (62,648,922)	\$ 1,053,957	\$ (61,594,965)

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

RECONCILIATION OF THE CHANGE IN FUND BALANCES OF  
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

Year ended June 30, 2006

Net change in fund balances - total governmental funds			\$(10,250,539)
Amounts reported for governmental activities in the statement of activities are different because:			
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets are depreciated over their estimated useful lives.			
Expenditures for capital assets	\$ 594,703		
Less current year depreciation and other changes	<u>(987,239)</u>	(392,536)	
Change in long-term compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.			(439,803)
Change in workers' compensation liability reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.			<u>(80,428)</u>
Change in net assets of governmental activities			<u><u>\$(11,163,306)</u></u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL - GENERAL FUND

Year ended June 30, 2006

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
Revenues				
State allotments	\$690,284,243	\$686,905,052	\$645,989,313	\$ (40,915,739)
Expenditures				
Health care programs	410,381,408	409,485,822	402,341,249	7,144,573
General welfare assistance, employment and support services	115,476,976	109,244,194	107,834,124	1,410,070
Child welfare and adult community care services	140,111,400	141,331,486	109,661,870	31,669,616
Vocational rehabilitation and services for the blind	3,890,808	3,890,808	3,881,765	9,043
Youth prevention, delinquency and correction services	11,916,408	13,945,499	13,530,900	414,599
General administration	8,407,085	8,907,085	8,906,417	668
Commission on the status of women / Commission on fatherhood	100,158	100,158	94,933	5,225
	<u>690,284,243</u>	<u>686,905,052</u>	<u>646,251,258</u>	<u>40,653,794</u>
 EXCESS OF EXPENDITURES OVER REVENUES	 <u>\$ -</u>	 <u>\$ -</u>	 <u>\$ (261,945)</u>	 <u>\$ (261,945)</u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL - SPECIAL REVENUE FUNDS

Year ended June 30, 2006

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
Revenues				
Intergovernmental revenues	\$889,456,995	\$908,326,322	\$862,532,607	\$ (45,793,715)
Expenditures				
Health care programs	600,702,372	600,702,372	592,045,346	8,657,026
General welfare assistance, employment and support services	141,936,677	140,323,392	105,118,135	35,205,257
Child welfare and adult community care services	118,920,528	138,773,140	137,939,510	833,630
Vocational rehabilitation and services for the blind	19,144,232	19,174,232	16,418,838	2,755,394
Youth prevention, delinquency and correction services	7,261,954	7,261,954	5,037,189	2,224,765
General administration	1,491,232	2,091,232	2,048,921	42,311
Commission on the status of women / Commission on fatherhood	-	-	18,585	(18,585)
	<u>889,456,995</u>	<u>908,326,322</u>	<u>858,626,524</u>	<u>49,699,798</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,906,083</u>	<u>\$ 3,906,083</u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF FIDUCIARY NET ASSETS - FIDUCIARY FUNDS

June 30, 2006

	ASSETS	<u>Agency Funds</u>	<u>Private Purpose Trust Fund</u>
Cash		<u>\$1,033,093</u>	<u>\$ 12,369</u>
Total assets		<u><u>\$1,033,093</u></u>	<u><u>\$ 12,369</u></u>
LIABILITIES AND NET ASSETS			
Due to individuals		\$ 715,050	\$ -
Due to others		<u>318,043</u>	<u>-</u>
Total liabilities		<u><u>\$1,033,093</u></u>	<u><u>-</u></u>
Net assets - held in trust			<u><u>\$ 12,369</u></u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS - FIDUCIARY FUNDS

Year ended June 30, 2006

	<u>Private Purpose Trust Fund</u>
Additions	
Donations	<u>\$ 14,331</u>
Total additions	<u>14,331</u>
Deductions	
Other	<u>1,962</u>
Total deductions	<u>1,962</u>
CHANGE IN NET ASSETS	12,369
Net assets at July 1, 2005	<u>-</u>
Net assets at June 30, 2006	<u><u>\$ 12,369</u></u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

**NOTE A – FINANCIAL REPORTING ENTITY**

The Hawaii State Government Reorganization Act of 1959 (Act 1, Second Special Session Laws of Hawaii 1959) created the Department of Social Services and Housing. In 1987, the name was changed to the Department of Human Services (DHS). The DHS administers programs that are designed to improve the social well being and productivity of the people of the State of Hawaii (State).

The DHS is part of the executive branch of the State. The DHS's basic financial statements reflect only its portion of the fund type categories. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually, which includes the DHS's financial activities.

The accompanying basic financial statements reflect the financial position and results of operations of the following activities of the DHS:

**Health Care Programs:** The activities of the Med-Quest division of the DHS include the Medical Assistance Program, which is designed to provide payments for medical services to eligible individuals and families. Services are provided through the Fee-for-Service Medicaid Program or through the managed care QUEST Program. Its operations are reported in the general, special revenue, and agency funds.

**General Welfare Assistance, Employment and Support Services:** The activities of the Benefit, Employment and Support Services division of the DHS provide economic support, employment, training, and educational services to welfare recipients; and child care services and opportunities for early childhood education to preserve and strengthen eligible families and to enable them to achieve personal and economic self-sufficiency. Its operations are reported in the general, special revenue, and agency funds.

**Child Welfare and Adult Community Care Services:** The activities of the Social Services division of the DHS include child welfare services and adult care services under the Social Security Act. In addition, the activities related to the medical waivers programs are included in this functional activity. Its operations are reported in the general, special revenue, and agency funds.

**Vocational Rehabilitation and Services for the Blind:** The activities of the Vocational Rehabilitation and Services for the Blind division of the DHS provide for the rehabilitation needs of those disabled persons who cannot meet their vocational needs without assistance. The goal of those services, which are provided to mentally, physically and visually handicapped individuals, is to assist recipients toward employment and the enjoyment of full and independent lives. Its operations are reported in the general, special revenue, and agency funds.

**Youth Prevention, Delinquency and Correction Services:** The activities of the Office of Youth Services of the DHS include developing and administering programs for preventing, rehabilitating and treating juvenile delinquency in the State. Its operations are reported in the general, special revenue, and agency funds.

**General Administration:** General administration includes management, accounting, data processing and other administrative services provided to the DHS. Those operations are reported in the general, special revenue, and agency funds.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE A – FINANCIAL REPORTING ENTITY (continued)**

**Commission on the Status of Women:** The activities of the Commission on the Status of Women of the DHS include working for equality for women and girls in the State by acting as a catalyst for positive change through advocacy, education, collaboration, and program development. Its operations are reported in the general and special revenue funds.

**Commission on Fatherhood:** The activities of the Commission on Fatherhood of the DHS include promoting healthy relationships between parents and children and emphasizing the importance of fathers being present in the home. Its operations are reported in the special revenue fund.

The DHS has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the DHS are such that exclusion would cause the DHS' financial statements to be misleading or incomplete. The Governmental Accounting Standards Board (GASB) has set forth criteria to be considered in determining financial accountability.

**NOTE B – SIGNIFICANT ACCOUNTING POLICIES**

1. Basis of Presentation

The government-wide financial statements report all assets, liabilities, and activities of the DHS as a whole. The fiduciary funds are excluded from the government-wide financial statements because the DHS cannot use those assets to finance its operations.

The financial transactions of the DHS are recorded in individual funds that are reported in the fund financial statements and are described in the following sections. Each fund is considered a separate accounting entity. The operations of each are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, and expenditures.

The fund financial statements focus on major funds rather than reporting funds by type. Each major fund is reported in separate columns and non-major funds are combined in one column. Major funds are funds which have total assets, liabilities, revenues or expenditures of the fund that are at least ten percent of the same element for all funds of its fund type or at least five percent of the same element for all governmental funds combined.

a. Governmental Fund Types

General Fund – The general fund is the general operating fund of the DHS. It is used to account for all financial activities except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted.

Special Revenue Funds – Special revenue funds are used to account for the proceeds of specific revenue sources that are legally or contractually restricted to expenditures for specified purposes.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)**

1. Basis of Presentation (continued)

b. Fiduciary Fund Type

Trust and Agency Funds – Trust and agency funds are used to account for assets held by the DHS in a trustee capacity or as an agent for individuals, private organizations, other governmental agencies, and / or other funds.

2. Measurement Focus and Basis of Accounting

a. Government-wide Financial Statements

The economic resources measurement focus and accrual basis of accounting are used for reporting the government-wide financial statements. With this measurement focus, all assets and liabilities associated with the operations of the DHS are included on the statement of net assets, except those related to the agency funds. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recorded at the time liabilities are incurred. Revenue from grants is recognized when all eligibility requirements have been satisfied.

b. Governmental Funds

All governmental funds are accounted for using a current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period when they become both measurable and available. Measurable means that the amount of the transaction can be determined. Available means that the amount is collected in the current fiscal year or soon enough after fiscal year end (60 days) to liquidate liabilities existing at the end of the fiscal year. Revenues susceptible to accrual include federal grants and funds appropriated by the State Legislature and allotted by the Governor. Expenditures are generally recorded when the related fund liabilities are incurred.

c. Fiduciary Funds

Agency Funds

Agency funds are used to account for resources held by the DHS as an agent for individuals, private organizations, other governmental agencies, and / or other funds. Agency funds are custodial in nature (i.e., assets equal liabilities) and do not involve measurement of results of operations.

Private Purpose Trust Fund

The private purpose trust fund is used to account for donations received by the DHS which are used to benefit clients of the Ho'opono, Services for the Blind Program under the Vocational Rehabilitation and Services for the Blind division.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)**

3. Use of Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

4. Receivables

Receivables in the general and special revenue funds consist primarily of amounts due from recipients of welfare benefit overpayments. The amounts reported as net receivables were established based on management's estimate of amounts collectible.

5. Capital Assets

Capital assets include land, improvements to land, buildings, building improvements, vehicles, machinery, equipment, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.

When capital assets are purchased, they are capitalized and depreciated using the straight-line method over their estimated useful lives in the government-wide financial statements. Capital asset purchases are recorded as expenditures of the period purchased in the governmental funds financial statements.

Capital assets are valued at cost where historical records are available and at estimated historical cost where no records exist. Donated capital assets are valued at their estimated fair value on the date received.

Improvements to capital assets that materially add to the value or extend the life of the assets are capitalized. Other repairs and normal maintenance are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

The State has adopted the following capitalization policy:

<u>Asset type</u>	<u>Minimum capitalization amount</u>	<u>Estimated useful life</u>
Land	All	Not applicable
Land improvements	\$100,000	15 years
Buildings and improvements	\$100,000	30 years
Furniture and equipment	\$5,000	7 years
Motor vehicles	\$5,000	5 years

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)**

6. Accumulated Vacation

Employees are credited with vacation at the rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the statement of net assets.

7. Due to Individuals

Due to individuals represents assets held by the DHS primarily in an agent capacity and is available to individuals receiving benefits under various programs primarily through the Electronic Benefits Transfer System.

8. Appropriations

Appropriations represent the authorizations granted by the State Legislature that permit a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year.

9. Operating and Capital Grants and Contributions

Federal grants and assistance awards are recorded as intergovernmental receivables and revenues when all eligibility requirements have been satisfied.

10. Intrafund and Interfund Transactions

Significant transfers of financial resources between activities included within the same fund are offset within that fund.

11. Risk Management

The DHS is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and workers' compensation. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

**NOTE C – BUDGETING AND BUDGETARY CONTROL**

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues and budgeted expenditures in the budgetary comparison schedules of the general and special revenue funds are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE C – BUDGETING AND BUDGETARY CONTROL (continued)**

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations such as those related to the special revenue funds.

For purposes of budgeting, the DHS's budgetary fund structure and accounting principles differ from those utilized to present the fund financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP). The DHS's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to (1) the encumbrance of purchase orders and contract obligations, (2) the recognition of certain receivables, and (3) special revenue funds operating grant accruals and deferrals. These differences represent a departure from GAAP.

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the year ended June 30, 2006.

	General	Special Revenue
Excess of revenues (under) over expenditures – actual on a budgetary basis	\$ (261,945)	\$ 3,906,083
Reserved for encumbrances at year end	11,463,844	56,588,266
Expenditures for liquidation of prior year encumbrances	(7,337,818)	(51,240,253)
Net change in unreserved liabilities	(10,661,443)	(61,180,026)
Accruals related to federal reimbursements for program expenditures	–	(36,754,545)
Net change in other receivables	379,071	110,837
Difference for revenues recognized for GAAP purposes	(4,544,823)	89,282,213
Net change in fund balance	\$(10,963,114)	\$ 712,575

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE D – CASH**

The State Director of Finance is responsible for safekeeping of all monies paid into the State Treasury (cash pool). The Hawaii Revised Statutes authorize the State Director of Finance to invest in obligations of, or guaranteed by, the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions.

The DHS also maintains cash in banks which are held separately from cash in the State Treasury. As of June 30, 2006, the carrying amount of total bank deposits was approximately \$802,000 and the corresponding bank balances which are represented were approximately \$1,520,000. These deposits were exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. For demand or checking accounts and time certificates of deposit, the State requires that the depository banks pledge collateral based on daily available bank balances to limit its exposure to custodial credit risk. The use of daily available bank balances to determine collateral requirements results in available balances being under-collateralized at various times during the fiscal year. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State. The State also requires that no more than 60% of the State's total funds available for deposit and on deposit in the State Treasury may be deposited in any one financial institution.

**NOTE E – RECEIVABLES**

Receivables of the DHS, net of an allowance for doubtful accounts, consisted of the following at June 30, 2006:

	General	Special Revenue
Welfare benefit overpayments	\$22,239,110	\$26,042,890
QUEST premiums receivable	1,482,840	2,117,160
Social Security interim assistance loans	861,000	–
CSEA receivable	416,854	–
	24,999,804	28,160,050
Less allowance for doubtful accounts:		
Welfare benefit overpayments	21,226,360	24,855,640
QUEST premiums receivable	1,416,936	2,023,064
	22,643,296	26,878,704
Receivables – net	\$ 2,356,508	\$ 1,281,346

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE F – CAPITAL ASSETS**

The changes in capital assets were as follows:

	Government Activities					Balance June 30, 2006
	Balance July 1, 2005	Additions	Disposals	Net Transfers	Other	
Depreciable assets						
Buildings and improvements	\$46,185,353	\$ -	\$ -	\$ -	\$ -	\$46,185,353
Furniture, equipment and vehicles	7,892,517	594,703	(367,045)	11,223	(25,260)	8,106,138
Nondepreciable assets						
Land	6	-	-	-	-	6
Total at historical cost	54,077,876	594,703	(367,045)	11,223	(25,260)	54,291,497
Less accumulated depreciation for:						
Buildings and improvements	13,320,515	1,533,553	-	-	(617,340)	14,236,728
Furniture, equipment and vehicles	6,724,293	668,240	(314,261)	14,024	(678,059)	6,414,237
Total accumulated depreciation	20,044,808	2,201,793	(314,261)	14,024	(1,295,399)	20,650,965
Total capital assets – net	<u>\$34,033,068</u>	<u>\$(1,607,090)</u>	<u>\$(52,784)</u>	<u>\$ (2,801)</u>	<u>\$ 1,270,139</u>	<u>\$33,640,532</u>

Depreciation expense was charged to functions as follows:

	Governmental Activities
Health care programs	\$ 713,872
General welfare assistance, employment and support services	456,405
Child welfare and adult community care services	130,894
Vocational rehabilitation and services for the blind	65,980
Youth prevention, delinquency and correction services	765,532
General administration	69,110
	<u>\$2,201,793</u>

**NOTE G – RELATED PARTY TRANSACTIONS**

The DHS had various amounts due to the State totaling \$57,468,846 as of June 30, 2006, which included federal reimbursements for program expenditures totaling \$55,407,529, receivables totaling \$1,873,750, and cash held outside of the State Treasury totaling \$187,567. The DHS had a receivable due from the State totaling \$24,234 as of June 30, 2006.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE G – RELATED PARTY TRANSACTIONS (continued)**

Under ACT 41, SLH of 2004, the State Department of Health (DOH) is required to transfer the State share of Developmentally, Disabled, Mentally Retarded (DDMR) Medicaid Waiver claims with dates of service during the year ended June 30, 2005 and prior and claims for Medicaid clients residing in ICF-MR beds to DHS. The State share of the claims is budgeted for in the DOH's general funds. The DHS had a receivable due from the DOH for these claims which totaled \$4,266,500 as of June 30, 2006. Effective on July 1, 2005, the DOH is responsible for paying providers for DDMR claims with dates of service during the year ended June 30, 2006 and thereafter directly and DHS is responsible for transferring funds to the DOH for the federal share of the claims. These claims were previously paid by DHS. The DHS had a liability due to the DOH for these claims which totaled \$7,500,000 as of June 30, 2006.

The DHS transfers funds to the DOH for the federal share of Medicaid rehab option claims and for the federal share of certain capitation and administrative costs. The DHS had a liability due to the DOH for these costs which totaled \$25,403,185 as of June 30, 2006.

The DHS had a receivable due from the State Department of Budget and Finance totaling \$200,000 as of June 30, 2006 for the funding of two appropriations.

The DHS leases office space from a State agency. The DHS's general fund share of the lease costs is paid from the State General Fund. The DHS's federal share of the costs paid to the State amounted to \$319,278 for the year ended June 30, 2006.

**NOTE H – ACCRUED COMPENSATED ABSENCES**

Accrued compensated absences is not reported in the governmental fund financial statements as that amount is not expected to be paid with current funds. The government-wide financial statements present the cost of accumulated unpaid compensated absences as a liability. A reconciliation of changes in the accrued compensated absences liability during the year ended June 30, 2006 was as follows:

	<u>Amount</u>
Balance at July 1, 2005	\$14,689,461
Additions	7,574,762
Reductions	<u>(7,134,959)</u>
Balance at June 30, 2006	15,129,264
Less current portion	<u>(5,343,000)</u>
	<u>\$ 9,786,264</u>

The accrued compensated absences liability has been paid primarily by the general fund in the past.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE I – INSURANCE**

Insurance coverage is maintained at the State level. The State is substantially self-insured for all perils including workers' compensation. Expenditures for workers' compensation and other insurance claims are appropriated annually from the State General Fund.

Under the provisions of GASB Statement No. 10, liabilities related to certain types of losses (including torts, theft of, damage to, or destruction of assets, errors or omissions, natural disasters and injuries to employees), are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

During the year ended June 30, 2006, the DHS was covered by the State's self-insured workers' compensation program for medical expenses of the injured DHS employees. However, the DHS was required to pay Temporary Total Disability (TTD) and Temporary Partial Disability (TPD) benefits for employees on the DHS' payroll. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

A reconciliation of changes in the workers' compensation liability during the year ended June 30, 2006 was as follows:

	<u>Amount</u>
Balance at July 1, 2005	\$ 221,738
Additions	263,035
Reductions	<u>(182,607)</u>
Balance at June 30, 2006	<u>\$ 302,166</u>

The workers' compensation liability has been paid primarily by the general fund in the past.

**NOTE J – INTERFUND RECEIVABLE AND PAYABLE**

The general fund had a receivable due from the special revenue fund totaling \$55,407,529 as of June 30, 2006 for federal reimbursements of program expenditures.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE K – NON-IMPOSED EMPLOYEE FRINGE BENEFITS**

Payroll fringe benefit costs of the DHS's employees that are funded by state appropriations (general fund) are assumed by the State and are not charged to the DHS's operating funds. These costs, totaling approximately \$21,049,000 for the year ended June 30, 2006 have been reported as revenues and expenditures in the general fund of the DHS.

Payroll fringe benefit costs related to federally-funded salaries are not assumed by the State and are recorded as expenditures in the special revenue funds of the DHS.

**NOTE L – FUND BALANCE DEFICITS**

The general and special revenue funds of the DHS have deficits in the unreserved fund balances at June 30, 2006 aggregating to \$74,112,766 and \$55,534,309, respectively. The general fund deficit resulted primarily from expenditures being recorded when incurred, and revenues being recognized only when corresponding funds are measurable and available. The special revenue fund deficit is because the encumbrances at June 30, 2006 were not liabilities and therefore the related revenues were not recorded.

**NOTE M – LEASE COMMITMENTS**

The DHS leases various office facilities on a long term basis under various operating leases expiring through 2023. Certain leases include renewal and escalation clauses. The DHS's general fund share of lease costs is paid from the State General Fund. The federal share of these lease costs allocable to programs is reported in the special revenue funds of the DHS. The following is a schedule of the federal share of minimum future rentals on noncancelable operating leases at June 30, 2006:

Year ending June 30,	Amount
2007	\$1,158,000
2008	1,151,000
2009	926,000
2010	574,000
2011	422,000
2012 – 2016	2,143,000
2017 – 2021	2,346,000
2022 – 2023	598,000
	<u>\$9,318,000</u>

The DHS's federal share of rent expense associated with operating leases for the year ended June 30, 2006 was approximately \$1,166,000, and is included in the accompanying financial statements.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE N – RETIREMENT BENEFITS**

1. Employees' Retirement System

Plan Description

All eligible employees of the State and counties are required by Chapter 88 of the Hawaii Revised Statutes (HRS) to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer defined benefit public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS is governed by a Board of Trustees. All contributions, benefits, and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues a comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan consisted of only a contributory plan. In 1984, legislation was enacted to add a new contributory plan for members of the ERS who are also covered under Social Security. Police officers, firefighters, judges, elected officials, and persons employed in positions not covered by Social Security are precluded from the noncontributory plan. The noncontributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new noncontributory plan and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory plans, respectively.

Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service excluding the vacation payment.

On July 1, 2006 a new hybrid contributory plan will become effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan will be eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan, will be eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 will be required to join the hybrid plan.

Funding Policy

Most covered employees of the contributory option are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the departments of the County Prosecuting Attorney and the Attorney General, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Effective July 1, 2005, employer contribution rates are a fixed

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE N – RETIREMENT BENEFITS (continued)**

1. Employees' Retirement System (continued)

Funding Policy (continued)

percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

The State's contribution requirements as of June 30, 2006, 2005, and 2004 were approximately \$318,144,000, \$251,685,000, and \$181,614,000, respectively. The State contributed 100% of its required contributions for those years.

2. Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87, provides certain health care and life insurance benefits to all qualified employees.

For employees hired before July 1, 1996, the State pays the entire monthly health care premium for employees retiring with ten or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than ten years of credited service.

For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, the State pays the entire health care premium.

There are approximately 26,000 state retirees receiving such benefits. Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive reimbursement of the basic medical coverage premium. Contributions are financed on a pay-as-you-go basis.

Effective July 1, 2003, the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) replaced the Hawaii Public Employees Health Fund under Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county employees, retirees, and their dependents.

3. Cost of Retirement Benefits

The DHS's general fund share of the expense for pension benefits for the year ended June 30, 2006 was paid from the State General Fund and approximate \$7,552,900. The DHS's federal share of the pension benefits expense for the year ended June 30, 2006 was approximately \$3,442,200. The employer contribution rate for the year ended June 30, 2006 was 13.41%.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE N – RETIREMENT BENEFITS (continued)**

3. Cost of Retirement Benefits (continued)

The DHS's general fund share of the expense for post-retirement benefits for the year ended June 30, 2006 was paid from the State General Fund and approximates \$3,677,800. The DHS's federal share of the post-retirement benefits expense for the year ended June 30, 2006 was approximately \$1,676,200.

The DHS's general and federal share of pension and post-retirement benefit expenses are included in the accompanying financial statements.

4. Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all State employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the State's or DHS's basic financial statements.

**NOTE O – RISK MANAGEMENT**

The DHS is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and workers' compensation. The State generally is at risk for the first \$250,000 per occurrence of property losses, the first \$1,000 per occurrence of credit / debit card forgery losses, the first \$500,000 per occurrence of all other crime losses, and the first \$4 million per occurrence with respect to general liability claims. Losses in excess of these retention amounts are insured with commercial insurance carriers. The limit per occurrence or in the aggregate for property losses is as follows: \$100 million for named hurricane and \$50 million for flood, earthquake, terrorism, and boiler and machinery. The limit per occurrence for crime losses is as follows: \$100,000 for credit / debit card forgery and \$10 million for all other crime losses. The limit per occurrence or in the annual aggregate for general liability is \$10 million. Losses that are not covered by insurance are paid from legislative appropriations of the State's General fund.

The State generally self-insures its automobile no-fault and workers' compensation losses. Automobile losses are administered by third-party administrators. The State administers its workers' compensation losses.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2006

**NOTE P – COMMITMENTS AND CONTINGENCIES**

1. Accumulated Sick Leave

Employees earn sick leave credits at the rate of one and three-quarters working days for each month of service. Sick leave credits may be accumulated without limit, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for unpaid sick leave credits is reported in the accompanying financial statements. However, a DHS employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS. Accumulated sick leave as of June 30, 2006, amounted to approximately \$44,797,000.

2. Litigation

The DHS is a party to various legal proceedings, most of which normally occur in governmental operations. The DHS and its counsel are unable to express opinions as to the outcome of the litigation. It has been the State's historical practice that certain types of judgments and settlements against an agency of the State are paid from the State General Fund through an appropriation bill which is submitted annually by the Department of the Attorney General to the legislature. However, it is not known if this practice will continue or whether the legislature will adjust, either directly or indirectly, the DHS's budget in light of a settlement or judgment against the DHS.

SUPPLEMENTARY INFORMATION

Department of Human Services  
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year ended June 30, 2006

Federal grantor/pass-through grantor and program title	Federal CFDA number	Pass-through entity identifying number	Federal expenditures <sup>1</sup>	Amount provided to subrecipient
<b>U.S. Department of Health and Human Services</b>				
Promoting Safe and Stable Families	93.556		\$ 2,106,893	\$ -
Temporary Assistance for Needy Families	93.558		73,065,391	21,952,451
Low-Income Home Energy Assistance	93.568		2,135,254	-
Child Care and Development Block Grant	93.575		22,309,186	2,278,768
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		12,395,016	-
Chafee Education and Training Vouchers Program (ETV)	93.599		141,879	-
Head Start	93.600		168,355	-
Children's Justice Grants to States	93.643		111,288	-
Child Welfare Services_State Grants	93.645		1,349,369	-
Foster Care_Title IV-E	93.658		22,664,837	-
Adoption Assistance	93.659		11,142,536	-
Social Services Block Grant	93.667		19,600,821	1,791,361
Child Abuse and Neglect State Grants	93.669		126,032	-
Family Violence Prevention and Services/Grants for Battered Women's Shelters_Grants to States and Indian Tribes	93.671		795,099	-
Chafee Foster Care Independence Program	93.674		611,790	-
State Children's Insurance Program	93.767		12,147,046	-
State Survey and Certification of Health Care Providers and Suppliers	93.777		410,333	-
Medical Assistance Program	93.778		649,589,634	-
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	93.779		169,807	-
Pass-through State Department of Labor and Industrial Relations Refugee and Entrant Assistance_State Administered Programs	93.566		36,516	-
Pass-through Partners In Development Native American Programs	93.612	90NA7748/01	62,472	-
<b>Total U.S. Department of Health and Human Services</b>			831,139,554	26,022,580
<b>U.S. Department of Agriculture</b>				
Food Stamps <sup>2</sup>	10.551		149,952,630	-
State Administrative Matching Grants for Food Stamp Program	10.561		10,802,027	505,945
<b>Total U.S. Department of Agriculture</b>			\$160,754,657	\$ 505,945

Department of Human Services  
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2006

Federal grantor/pass-through grantor and program title	Federal CFDA number	Pass-through entity identifying number	Federal expenditures <sup>1</sup>	Amount provided to subrecipient
<b>U.S. Department of Justice</b>				
Juvenile Accountability Incentive Block Grants	16.523		\$ 1,122,565	\$ 976,881
Juvenile Justice and Delinquency Prevention_Allocation to States	16.540		788,911	621,585
Title V_Delinquency Prevention Program	16.548		16,304	11,758
Part E_State Challenge Activities	16.549		123,824	118,841
Edward Byrne Memorial Formula Grant Program	16.579		297,538	-
<b>Total U.S. Department of Justice</b>			2,349,142	1,729,065
<b>U.S. Department of Labor</b>				
Pass-through State Department of Labor and Industrial Relations				
Senior Community Service Employment Program	17.235	PY02-SCSEP-CC-DHS	225,454	-
Work Incentive Grants	17.266	WI-13249-03-60	150,300	-
<b>Total U.S. Department of Labor</b>			375,754	-
<b>U.S. Department of Education</b>				
Rehabilitation Services_Vocational Rehabilitation Grants to States	84.126		10,890,316	149,924
Rehabilitation Long-Term Training	84.129		81,850	-
Independent Living_State Grants	84.169		224,489	222,984
Rehabilitation Services_Independent Living Services for Older Individuals Who are Blind	84.177		266,503	-
Supported Employment Services for Individuals with Severe Disabilities	84.187		346,800	322,600
Assistive Technology	84.224		436,154	436,154
Projects with Industry	84.234		34,329	-
Rehabilitation Services Demonstration and Training Programs	84.235		229,508	-
Rehabilitation Training_State Vocational Rehabilitation Unit In-Service Training	84.265		21,580	-
Safe and Drug-Free Schools and Communities_State Grants	84.186		110,348	88,018
<b>Total U.S. Department of Education</b>			\$ 12,641,877	\$ 1,219,680

Department of Human Services  
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2006

Federal grantor/pass-through grantor and program title	Federal CFDA number	Pass-through entity identifying number	Federal expenditures <sup>1</sup>	Amount provided to subrecipient
<b>Corporation for National and Community Service</b>				
Foster Grandparent Program	94.011		\$ 477,494	\$ -
Senior Companion Program	94.016		386,019	-
<b>Total Corporation for National and Community Service</b>			863,513	-
<b>Social Security Administration</b>				
Social Security_Disability Insurance (DI)	96.001		5,115,524	-
<b>Total Social Security Administration</b>			5,115,524	-
<b>TOTAL FEDERAL EXPENDITURES</b>			<b>\$1,013,240,021</b>	<b>\$29,477,270</b>

<sup>1</sup>The accompanying schedule of expenditures of federal awards is prepared on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

<sup>2</sup>Expenditures represent assistance utilized through the Electronic Benefits Transfer System.

**PART II**

**AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING AND ON COMPLIANCE AND OTHER MATTERS**

Report of Independent Certified Public Accountants on  
Internal Control over Financial Reporting and on Compliance and Other Matters  
Based on an Audit of Financial Statements Performed in Accordance  
with *Government Auditing Standards*

The Auditor  
State of Hawaii

We have audited the accompanying financial statements of the governmental activities and of each major fund of the Department of Human Services, State of Hawaii (DHS), as of and for the year ended June 30, 2006, which collectively comprise the DHS's basic financial statements as listed in the table of contents. We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the DHS's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Accordingly, we express no such opinion. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the DHS's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-1 and 06-2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

The Auditor  
State of Hawaii

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the DHS's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of the laws, regulations, contracts, and grant agreements including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We also noted certain additional matters that we reported to management of DHS in a separate letter dated August 10, 2007.

This report is intended solely for the information and use of the Auditor, management of DHS, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Honolulu, Hawaii  
August 10, 2007

**PART III**

**AUDITORS' REPORT ON COMPLIANCE  
WITH REQUIREMENTS APPLICABLE TO EACH MAJOR  
PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE**

Report of Independent Certified Public Accountants on Compliance  
with Requirements Applicable to each Major Program and on Internal Control  
over Compliance in Accordance with OMB Circular A-133

The Auditor  
State of Hawaii

### Compliance

We have audited the compliance of the Department of Human Services, State of Hawaii (DHS) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2006. The DHS's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the DHS's management. Our responsibility is to express an opinion on the DHS's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the DHS's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the DHS's compliance with those requirements.

As described in items 06-03 to 06-23 in the accompanying schedule of findings and questioned costs, the DHS did not comply with the following requirements:

CFDA number	Name of federal program	Type of compliance requirement	Ref. no.
93.558	Temporary Assistance to Needy Families	Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Eligibility	06-3, 06-4, 06-5
93.777 and 93.778	Medicaid Cluster	Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Eligibility, Special Tests and Provisions	06-3, 06-6, 06-7, 06-8, 06-9, 06-10, 06-11, 06-12, 06-13
93.659	Adoption Assistance	Activities Allowed or Unallowed, Eligibility	06-14

The Auditor  
State of Hawaii

CFDA number	Name of federal program	Type of compliance requirement	Ref. no.
93.575 and 93.596	Child Care Cluster	Activities Allowed or Unallowed, Eligibility, Subrecipient Monitoring	06-15, 06-16
93.658	Foster Care_Title IV-E	Activities Allowed or Unallowed, Eligibility	06-17, 06-18, 06-19
93.667	Social Services Block Grant	Earmarking	06-20
93.767	State Children's Insurance Program	Eligibility	06-21
10.551 and 10.561	Food Stamp Cluster	Allowable Costs/Cost Principles, Subrecipient Monitoring, Special, Tests and Provisions	06-3, 06-22, 06-23

Compliance with such requirements is necessary, in our opinion, for the DHS to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the DHS complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006.

### Internal Control Over Compliance

The management of the DHS is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the DHS's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133 and not to provide an opinion on the internal control over compliance. Accordingly, we express no such opinion.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the DHS's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-3 to 06-23.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 06-3 through 06-23 to be material weaknesses.

The Auditor  
State of Hawaii

This report is intended solely for the information and use of the Auditor, management of DHS, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Grant Thornton LLP*

Honolulu, Hawaii  
August 10, 2007

**PART IV**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2006

Section I – Summary of Auditor’s Results

*Financial Statements*

Type of auditor’s report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? \_\_\_ yes       no
- Reportable condition(s) identified that are not considered to be material weaknesses?  yes      \_\_\_ none reported
- Noncompliance material to financial statements noted? \_\_\_ yes       no

*Federal Awards*

Internal control over major programs:

- Material weakness(es) identified?  yes      \_\_\_ no
- Reportable condition(s) identified that are not considered to be material weakness(es)? \_\_\_ yes       none reported

Type of auditor’s report issued on compliance for major programs: Qualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133, Section .510(a)?  yes      \_\_\_ no

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program</u>
10.551	Food Stamps
10.561	State Administrative Matching Grants for Food Stamp Program
84.126	Rehabilitation Services_Vocation Rehabilitation Grants to States
93.558	Temporary Assistance for Needy Families
93.575	Child Care and Development Block Grant
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund
93.658	Foster Care_Title IV-E
93.659	Adoption Assistance
93.667	Social Services Block Grant
93.767	State Children’s Insurance Program
93.777	State Survey Certification of Health Care Providers and Suppliers
93.778	Medical Assistance Program
96.001	Social Security_Disability Insurance (DI)

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

Dollar threshold used to distinguish between Type A and Type B programs: \$3,039,720

Auditee qualified as low-risk auditee?  yes  no

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Section II – Financial Statement Findings

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**Ref.**

**no. Internal Control Findings**

**06-1 Properly Record All Fixed Assets in the State Property Inventory Records**

**Criteria:** Divisions within the DHS are responsible for reporting the acquisition and disposal of fixed assets to the State Procurement Office on a quarterly basis to update the state property inventory records.

Section 103D-1206 of the Hawaii Revised Statutes states in part, "...the administrative heads of the executive departments, and all other persons, offices, and boards of a public character...shall prepare and file with the administrator of the state procurement office an annual inventory return of state property in the possession, custody, control, or use of the officer making the return, or of the department or office of the government over which the officer presides...."

Although the DHS has implemented stricter departmental inventory procedures to properly report fixed asset purchases to the State Procurement Office, personnel did not always adhere to the established procedures.

The State Department of Accounting and General Services (DAGS) uses the information from the state property inventory records to assist the DHS in compiling the department's fixed assets and depreciation information for the year.

**Condition:** Based on this information and our review of 30 fixed asset purchases, we noted the following conditions:

- The DHS changed the carrying value of items that were acquired in previous years to correctly state the cost of the assets. There were several instances where the items' carrying value was corrected with a net change to the fixed asset listing of \$(4,582).
- There were several instances where the DHS did not perform inventory procedures on furniture and equipment and motor vehicle items, resulting in an understatement to the fixed asset listing of \$(609,897).

**Questioned Costs:** We identified no questioned costs.

**Context:** Capital assets, net of accumulated depreciation totaled \$33,641,000 as of June 30, 2006.

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Internal Control Findings (continued)**

**Effect:** Capital assets was understated by \$(609,897).

**Cause:** The findings described above were primarily due to clerical error / oversight, a misunderstanding of whether the purchasing unit or the unit that maintains the items was responsible for performing inventory procedures, and failure to perform a reconciliation between the DHS's internal records and the quarterly transaction register provided to the DHS by the State Department of Accounting and General Services.

**Recommendation:** To ensure that the state property inventory records are complete and accurate, the DHS should implement monitoring procedures to ensure that all appropriate personnel properly and accurately report all fixed asset acquisitions and dispositions to the State Procurement Office on a quarterly basis. The DHS should implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that the transactions were properly posted to the state property inventory records. The DHS's Property and Procurement Office issued an internal communication memorandum in November 2005 stating the purchasing unit of fixed asset items should be responsible for performing inventory procedures unless otherwise agreed upon.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

**06-2 Maintain Vacation and Sick Leave Records Properly**

**Criteria:** The DHS prepared a summary leave schedule to determine the amount of its accrued compensated absences liability and reported the liability to the State Comptroller. The liability was based on the balance of earned hours per individual leave records (Form DPS-7) multiplied by each employee's hourly salary rate.

**Condition:** During our review of 20 leave records and one month of Form G-1, *Application for Leave of Absence*, we noted the following conditions:

- There were 3 instances where the accrued vacation leave hours on the summary leave schedule did not agree to the individual Form DPS-7. This resulted in an understatement of accrued vacation leave totaling (8) hours or \$(116).
- There were 3 instances where the accumulated sick leave hours on the summary leave schedule did not agree to the individual Form DPS-7. This resulted in an understatement of accumulated sick leave totaling (149) hours or \$(6,239).
- There was 1 instance where the accrued compensatory time hours on the summary leave schedule did not agree to the individual Form DPS-7. This resulted in an understatement of accrued compensatory time totaling (1) hour or \$(11).

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Internal Control Findings (continued)**

- There was 1 instance where an employee's accrued vacation leave hours carried forward from their 2005 to 2006 Form DPS 7 exceeded the 720 hour limit. This resulted in an overstatement of accrued vacation leave totaling 14 hours or \$406.
- There were 14 instances where the Form G-1, *Application for Leave of Absence*, was authorized after the employee took vacation.
- There was 1 instance where there was no supervisor approval date indicated on the Form G-1, *Application for Leave of Absence*.

Although the DHS established procedures to conduct secondary reviews and quality control reviews of leave records, it appears that the leave records were not always updated accurately on a timely basis. In addition, although the DHS established procedures to conduct a secondary review of the summary leave schedule, it appears that the schedule was not accurately prepared.

**Questioned Costs:** We identified no questioned costs.

**Context:** The accrued compensated absences liability and accumulated sick leave totaled \$9,786,000 and approximately \$44,797,000, respectively, as of June 30, 2006.

**Effect:** The accrued compensated absences liability was overstated by \$279 and accumulated sick leave was understated by \$(6,239).

**Cause:** The findings described above were primarily due to clerical error / oversight.

**Recommendation:** We recognize that approvals of vacation could occur after the fact, such as when an employee must care for a dependent who becomes ill the night before. In those instances, we recommend that the employee's record be annotated to reflect that telephonic approval was given.

The DHS should increase the number of quality control reviews of leave records and perform them periodically throughout the year to ensure that vacation and sick leave and compensatory time records are accurately maintained and reviewed on a timely basis. The reviews should include ensuring that there is a secondary review performed on the leave records by the supervisor of the employee responsible for maintaining the records. In addition, a secondary review of the information used to prepare the summary leave schedule should be performed before compiling the schedule, including ensuring that the beginning balances are correct. These reviews should be documented with the initials of the employee responsible for performing the review.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

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Section III – Federal Award Findings and Questioned Cost

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**Ref.**

**no. Compliance and Internal Control Findings**

**06-3 Allocate Costs Properly**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.558, Temporary Assistance to Needy Families (TANF)  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)  
Federal Agency: U.S. Department of Agriculture  
CFDA 10.551, Food Stamps

**Criteria:** The DHS prepares a departmental cost allocation on a quarterly basis which allocates costs that are not directly chargeable to one specific program based on allocation methods contained in its cost allocation plan which is approved by the Director of the U.S. Department of Health and Human Services Division of Cost Allocation.

In accordance with the DHS's approved cost allocation plan, the DHS allocates costs incurred by the Administrative Appeals Office (AAO) based on the actual number of cases processed, by program, for the quarter. The AAO administrator prepares a memorandum which summarizes the number of cases processed, by program, for the cost allocation accountant to allocate the costs accordingly. The information included in the memorandum is based on a calculation prepared by the AAO Secretary.

**Condition:** During our review of the quarter end June 30, 2006 cost allocation, we noted differences in the number of cases processed, by program, per the memorandum prepared by the AAO administrator and the AAO's internal log. In addition, we noted the calculation supporting the information included in the memorandum is not reviewed by the AAO administrator.

**Questioned Costs:** During our review of the quarter end June 30, 2006 cost allocation, we noted costs incurred by the AAO totaling \$60 was erroneously over-charged to the TANF grant, \$104 was erroneously over-charged to the Medicaid; Title XIX grant, \$140 was erroneously over-charged to the Food Stamps grant, and \$(768) was erroneously under-charged to the programs included in the Title IV-E cost allocation.

**Context:** In 2006, the total AAO costs included in the departmental cost allocation was \$290,000.

**Effect:** The DHS has no assurance that the case counts are accurately calculated. Therefore, Federal programs may be over or under charged for the AAO costs included in the departmental cost allocation.

**Cause:** The finding described above was due to the clerical error of the employee responsible for calculating the case counts and the fact that there was no secondary review performed by the AAO administrator on the calculation.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**      **Compliance and Internal Control Findings**

**Recommendation:** To ensure that the costs contained in the DHS's departmental cost allocation are allocated properly, the DHS should ensure that a secondary review is performed on all supporting cost allocation documents by the supervisor of the employee responsible for preparing the documents. This review should be documented with the initials of the employee responsible for performing the review.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

**06-4      Improve Accuracy of TANF Benefit Payments**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.558, Temporary Assistance for Needy Families (TANF)

Award number: G0301HITANF; Award year: October 1, 2002 through September 30, 2003

Award number: G0401HITANF; Award year: October 1, 2003 through September 30, 2004

Award number: G0501HITANF; Award year: October 1, 2004 through September 30, 2005

Award number: G0601HITANF; Award year: October 1, 2005 through September 30, 2006

**Criteria:** According to 42 USC 601 and 45 CFR 260.20, the purpose of the TANF program is to provide assistance to needy families so that children may be cared for in their own homes or in the homes of relatives.

**Condition:** During our review of 30 TANF benefit payments, we noted 1 instance where an incorrect amount was paid to a family due to an error in the calculation of the monthly benefit amount. This resulted in an underpayment of \$145.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are \$73,065,000.

**Cause:** The finding described above is primarily due to clerical error/oversight.

**Effect:** This clerical error resulted in underpayment of basic TANF assistance.

**Recommendation:** We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the benefit payments being claimed for federal reimbursements. A secondary review would help to ensure that all required documents are properly completed and benefit payments are the correct amount.

**Views of responsible officials and planned corrective action:** See Response from Affected Agency.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

**06-05    Maintain All Required Documentation in TANF Case Files**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.558, Temporary Assistance for Needy Families (TANF)

Award number: G0301HITANF; Award year: October 1, 2002 through September 30, 2003

Award number: G0401HITANF; Award year: October 1, 2003 through September 30, 2004

Award number: G0501HITANF; Award year: October 1, 2004 through September 30, 2005

Award number: G0601HITANF; Award year: October 1, 2005 through September 30, 2006

**Criteria:** According to 45 CFR 260.31, to be eligible for TANF assistance, a family must include a minor child who lives with a parent or other adult caretaker relative. The child must be less than 18 years old, or less than 19 years old if a full-time student in a secondary school.

**Condition:** During our review of 30 TANF case files, we noted 4 instances where the case file did not have appropriate documentation to verify birth dates of children.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are \$73,065,000.

**Cause:** The findings above are primarily due to clerical error/oversight. In addition, we also noted a higher priority is placed on updating information in the database rather than maintaining the forms in the case files.

**Effect:** Clerical errors may result in overpayments of basic TANF assistance.

**Recommendation:** We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the benefit payments being claimed for federal reimbursements. A secondary review would help to ensure that all required documents are properly completed.

**Views of responsible officials and planned corrective action:** See Response from Affected Agency.

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

**06-06    Improve Utilization Controls over Medicaid Claims**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)  
Award number: 0505HI5048; Award year: October 1, 2004 through September 30, 2005  
Award number: 0605HI5048; Award year: October 1, 2005 through September 30, 2006

**Background:** The Hawaii Prepaid Medical Management Information System (HPMMIS) was implemented and is being operated and maintained by the Arizona Health Care Cost Containment System (AHCCCS). In addition, the management and processing of pharmacy benefits was contracted to Affiliated Computer Services (ACS).

As discussed in the prior year's auditors' report, the HPMMIS was not able to produce the Surveillance and Utilization Review reports. In addition, post payment reviews of electronic media claims was not being performed and the use of a third party healthcare auditing and consulting company to audit the pharmacy benefits manager's operations was discontinued.

Due to the complexity of the Medicaid processing function and the large volume of Medicaid transactions, it is imperative for DHS to obtain these necessary HPMMIS reports to ensure compliance with federal regulations.

**Criteria:** Title 42 CFR Part 456 Subpart A, requires a statewide program of control of the utilization of all Medicaid Services.

**Condition:** Based on our discussion with DHS personnel, we noted that DHS has been working with AHCCCS on obtaining these necessary HPMMIS reports. Meanwhile, the MQD continues to review claims payment on an ad hoc basis when payment issues are reported by DHS staff, ACS staff or providers.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are approximately \$650,000,000.

**Cause:** Failure to obtain the necessary HPMMIS management reports from AHCCCS.

**Effect:** Management's inability to perform post payment reviews of recipient utilization and provider services files and exception criteria resulted in noncompliance with federal grant guidelines.

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref. no.** **Compliance and Internal Control Findings (continued)**

**Recommendation:** DHS should obtain the necessary HPMMIS management reports to allow post payment review of recipient utilization and provider service profiles and exception criteria based on parameters set by the MQD.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

**06-07 Improve Accuracy of Medicaid Claims Processing**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)  
Award number: 0505HI5048; Award year: October 1, 2004 through September 30, 2005  
Award number: 0605HI5048; Award year: October 1, 2005 through September 30, 2006

**Background:** The Hawaii Prepaid Medical Management Information System (HPMMIS) was implemented and is being operated and maintained by the Arizona Health Care Cost Containment System (AHCCCS). In addition, the management and processing of pharmacy benefits was contracted to Affiliated Computer Services (ACS).

As discussed in the prior year's auditors' report, the HPMMIS was not able to produce the Surveillance and Utilization Review reports. In addition, post payment reviews of electronic media claims was not being performed and the use of a third party healthcare auditing and consulting company to audit the pharmacy benefits manager's operations was discontinued.

Due to the complexity of the Medicaid processing function and the large volume of Medicaid transactions, it is imperative for DHS to obtain these necessary HPMMIS reports to ensure compliance with federal regulations.

DHS contracted Heritage Information Systems, Inc. to perform pharmacy claims audits. The audit results will be used to correct and collect overpayments made by the ACS pharmacy benefits manager.

**Criteria:** According to OMB Circular A-133 and 42 CFR Sections 435.10, 440.210, 440.220, and 440.180, to be allowable, Medicaid costs for medical services must be: (1) covered by the State plan and waivers; (2) for an allowable service rendered (including supported by medical records or other evidence indicating that the service was actually provided and consistent with the medical diagnosis); (3) properly coded; and (4) paid at the rate allowed by the State plan. Additionally, Medicaid costs must be net of applicable credits (e.g., insurance, recoveries from other third parties who are responsible for covering the Medicaid costs, and drug rebates), paid to eligible providers, and only provided on behalf of eligible individuals.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref. no.** **Compliance and Internal Control Findings (continued)**

**Condition:** During our review of 120 claims (60 drug and 60 non-drug), we noted the following:

- 3 non-drug claims in which there was an aggregate overpayment of \$4,243. Approximately \$4,072 was related to a nursing facility services claim in which there was no prior authorization for the specified period.

**Questioned Costs:** \$4,243 based on the errors indicated in the conditions above.

**Context:** In 2006, total federal expenditures for this program are approximately \$650,000,000.

**Cause:** The findings above were primarily due to failure to obtain the necessary HPMMIS management reports from AHCCCS which would allow post-payment reviews of recipient utilization and provider service files and exception criteria based on parameters set by MQD.

**Effect:** Failure to improve the accuracy of Medicaid claims processing resulted in unallowable costs being charged to the federal grant.

**Recommendation:** DHS should perform regular post payment reviews on a sample of claims to detect processing errors and identify ways to improve the claims processing system and procedures.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

**06-08 Improve Controls over the Medicaid Drug Rebate Program**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers

CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Award number: 0505HI5048; Award year: October 1, 2004 through September 30, 2005

Award number: 0605HI5048; Award year: October 1, 2005 through September 30, 2006

**Background:** Med-Quest Division (MQD) contracts with Affiliated Computer Services, Inc. (ACS) to perform the daily operations of the drug rebate program including billing, collection, accounting and dispute resolution. On a quarterly basis, the MQD reports the drug rebates invoiced and drug rebate collections including any interest received on Form CMS 64.9R. This amount is used to reduce the amount to be reimbursed by the federal agency for the federal share of expenditures for the Medicaid Program. As discussed in prior year's audit, the MQD did not have adequate controls to verify if rebate interest payments were collected.

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**Criteria:** The Centers for Medicare and Medicaid (CMS) program release No. 29 requires that interest must be collected and cannot be disregarded as part of the dispute resolution process by either the manufacturer or the State. CMS program release No. 65 further clarifies that although the obligation for calculating the interests due to the States on late rebate payments rests with the manufacturer, it is the State's responsibility to track the collection of interest due, and report those amounts to CMS.

**Condition:** During our review of the drug rebate collection supporting schedules, we noted only minimal voluntary interest being collected. As a result, the federal agency may be overcharged for the federal share of expenditures.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are approximately \$650,000,000.

**Cause:** The MQD does not have controls in place to verify if rebate interest payments were collected.

**Effect:** Lack of controls to verify if rebate interest payments were collected resulted in noncompliance with federal grant guidelines.

**Recommendation:** DHS should establish procedures to monitor their subcontractor to ensure rebate interest payments are collected and not disregarded as part of the dispute resolution process by either the manufacturer or the DHS.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

**06-9 Maintain All Required Documentation in Medicaid Case Files**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers

CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Award number: 0505HI5048; Award year: October 1, 2004 through September 30, 2005

Award number: 0605HI5048; Award year: October 1, 2005 through September 30, 2006

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**Criteria:** Title 42 CFR Section 431.17 requires the maintenance of individual records on each applicant and recipient that contain information on the date of application, date and basis for disposition, facts essential to determine initial and continuing eligibility, provision of medical assistance, basis for discontinuing assistance and disposition of income and eligibility verification information.

**Condition:** During our review of 30 Medicaid case files, we noted 3 case files in which application, renewal and/or eligibility determination forms were missing or not properly completed.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are approximately \$650,000,000.

**Cause:** Often a lack of time and resources, clerical error and oversight have contributed to the findings described above. In addition, we also noted a higher priority is placed on updating the information in the database rather than completing the forms in the case files.

**Effect:** Failure to maintain supporting documentation to support eligibility determinations resulted in noncompliance with federal grant guidelines.

**Recommendation:** DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the medical assistance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

**06-10 Complete Medicaid Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers

CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Award number: 0505HI5048; Award year: October 1, 2004 through September 30, 2005

Award number: 0605HI5048; Award year: October 1, 2005 through September 30, 2006

**Criteria:** Title 42 CFR Part 435.911 requires the determination of eligibility to be made within 45 days from the date of application for all applicants except for applications made on the basis of disability in which it is 60 days. Title 42 CFR Section 435.916 also requires the redetermination of eligibility of Medicaid recipients with respect to circumstances that may change (e.g., income eligibility), at least every 12 months.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**

**Compliance and Internal Control Findings (continued)**

**Condition:** As of June 30, 2006, we found 326 applications outstanding greater than 45 days compared to 675 applications as of June 30, 2005 for the MQD. In addition, the number of overdue annual re-verifications for MQD was 1,427 as of June 30, 2006 compared to 1,004 as of June 30, 2005. While the number of applications outstanding greater than 45 days decreased by approximately 52 percent, the number of overdue annual re-verifications for MQD increased by approximately 42 percent from the prior year. Staffing problems continue to contribute to the backlog of applications, pending eligibility determinations, and overdue annual re-verifications.

In June 2004, the Eligibility Branch introduced passive renewals for families with children in an attempt to reduce the number of overdue annual re-verifications, however, the number of overdue annual re-verifications for MQD as of June 30, 2006 increased compared to the prior year.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are approximately \$650,000,000.

**Cause:** In order to reduce the backlog of applications, the DHS MQD Eligibility Branch adopted policies of presumptive eligibility and client self-declaration. Presumptive eligibility requires that applicants receive services if a decision on eligibility has not been made within the above specified timeframe. Self-declaration requires eligibility determinations to be based on the information provided on the application form. Self-declared information is supposed to be verified by the EB whenever possible; however, such verification is often not performed until the annual eligibility review for redetermination. While these procedural changes have reduced the backlog of outstanding applications, they have increased the likelihood that ineligible persons may be receiving benefits and also placed more reliance on subsequent eligibility re-verifications to verify clients remain eligible to receive benefits.

**Effect:** Failure to perform timely eligibility determinations and annual redeterminations resulted in noncompliance with federal grant guidelines.

**Recommendation:** DHS should assess the staffing needs at the Eligibility Branch and make every effort to ensure each unit is fully staffed with trained personnel in order to timely process applications and perform annual re-verifications. Adequate staffing would likely reduce the backlog of applications, pending eligibility determinations, and overdue annual re-verifications and also minimize the risk that ineligible recipients are receiving Medicaid benefits.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**

**Compliance and Internal Control Findings (continued)**

**06-11 Maintain All Required Medicaid Provider Documentation**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers

CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Award number: 0505HI5048; Award year: October 1, 2004 through September 30, 2005

Award number: 0605HI5048; Award year: October 1, 2005 through September 30, 2006

**Criteria:** In order to receive Medicaid payments, providers are required to be licensed in accordance with federal, State and local laws and regulations to participate in the Medicaid program. Providers are also required to have a current and valid written agreement on file with MQD except for providers for the Social Services Division and State of Hawaii Department of Health, Adult Mental Health Division which use contracts in place of provider agreements. A completed and signed Provider Information Form (Form 1139) constitutes the full written agreement. Title 42 CFR Part 455, Subpart B also requires providers to make certain required disclosures to the State. These required disclosures are included in the Provider Information Form and contracts.

**Condition:** In our review of 25 MQD provider files, we noted the following:

- 11 cases where the provider agreement was not present.
- 13 cases where other required documents were not present.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are approximately \$650,000,000.

**Cause:** MQD did not maintain documentation supporting provider eligibility.

**Effect:** Failure to maintain signed provider agreements and other required documentation resulted in noncompliance with federal grant guidelines. As a result, payments may have been made to ineligible providers.

**Recommendation:** DHS should ensure all provider agreements are properly completed and maintained.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**06-12 Implement Controls To Ensure the Medicaid Program is Credited Timely for Outstanding or Uncashed Checks**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers

CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Award number: 0505HI5048; Award year: October 1, 2004 through September 30, 2005

Award number: 0605HI5048; Award year: October 1, 2005 through September 30, 2006

**Criteria:** CFR Title 42, Section 433.40(c) requires the State to credit the Medicaid program for checks that are outstanding or uncashed beyond 180 days of issuance. If the State has claimed and received Federal Financial Participation (FFP) for the amount of the uncashed check, it must refund the amount of FFP received. At the end of each calendar quarter, the State must identify those checks which remain uncashed beyond a period of 180 days after issuance. The State must refund all FFP that it received for uncashed checks by adjusting the Quarterly Statement of Expenditures for that quarter.

**Condition:** Med-Quest Division (MQD) contracts with Affiliated Computer Services, Inc. (ACS) to serve as the Medicaid fiscal agent. ACS is responsible for paying fee-for-service claims. During our audit, we noted 22 checks were outstanding or uncashed beyond 180 days of issuance totaling \$10,415 of which the MQD claimed and received FFP for \$6,113 as of June 30, 2006.

**Questioned Costs:** \$6,113 in FFP received for outstanding or uncashed checks beyond 180 days as of June 30, 2006.

**Context:** In 2006, total federal expenditures for this program are approximately \$650,000,000.

**Cause:** MQD did not have adequate controls to monitor ACS's monthly bank reconciliations to properly credit the Medicaid program for checks that are outstanding or uncashed beyond 180 days of issuance.

**Effect:** Failure to properly credit the Medicaid program for checks that are outstanding or uncashed beyond 180 days of issuance resulted in noncompliance with federal grant guidelines.

**Recommendation:** DHS should implement controls to adequately monitor ACS's monthly bank reconciliations to properly credit the Medicaid program for checks that are outstanding or uncashed beyond 180 days of issuance.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

**06-13    Improve the Accuracy of Medicaid Reports**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers

CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Award number: 0505HI5048; Award year: October 1, 2004 through September 30, 2005

Award number: 0605HI5048; Award year: October 1, 2005 through September 30, 2006

**Background:** Med-Quest Division (MQD) contracts with Affiliated Computer Services, Inc. (ACS) to perform the daily operations of the drug rebate program including billing, collection, accounting and dispute resolution. On a quarterly basis, the MQD reports the drug rebates invoiced and drug rebate collections including any interest received on Form CMS 64.9R. This amount is used to reduce the amount to be reimbursed by the federal agency for the federal share of expenditures for the Medicaid Program.

**Criteria:** Title 45 CFR Section 92.20 (b)(3) requires that financial management systems provide for the effective control over and accountability for all funds, property, and other assets.

**Condition:** During our review of the quarterly Medicaid Drug Rebate Schedule Form CMS 64.9R for the period July 1, 2005 through June 30, 2006, we noted differences in drug rebates invoiced of \$1,011,136 and \$3,382,659 between the Medicaid Drug Rebate Schedule Form CMS 64.9R and the supporting documentation provided by ACS for the quarters ended March 31, 2006 and June 30, 2006, respectively. As a result, inaccurate information regarding the amount of drug rebates invoiced and the drug rebate receivable balance was submitted on the Medicaid Drug Rebate Schedule Form CMS 64.9R for the quarters ended March 31, 2006 and June 30, 2006.

We did note, however, that the amount of rebates collected except for interest were properly reported on the Medicaid Drug Rebate Schedule Form CMS 64.9R.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are approximately \$650,000,000.

**Cause:** MQD did not note the error upon submission of the quarterly CMS-64 report.

**Effect:** Failure to report accurate and reliable information resulted in noncompliance with federal grant guidelines.

**Recommendation:** DHS should ensure that complete and accurate information is submitted on the Medicaid Drug Rebate Schedule Form CMS 64.9R.

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref. no.** **Compliance and Internal Control Findings (continued)**

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

**06-14 Maintain All Required Documentation in Adoption Assistance Case Files**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.659, Adoption Assistance -Title IV-E

Award number: 0501HI1407; Award year: October 1, 2004 through September 30, 2005

Award number: 0601HI1407; Award year: October 1, 2005 through September 30, 2006

**Criteria:** According to 42 USC 673(a)(2), adoption assistance subsidy payments may be paid on behalf of eligible children to adoptive parents based on the need(s) of the child and the circumstances to the adoptive parents. In addition, according to 45 CFR Section 1356.41, nonrecurring expenses of adoption may be paid on behalf of eligible children if certain requirements are also met.

**Condition:** During our review of 30 adoption assistance case files, we noted 13 case files in which required forms were missing or not properly completed including the amount, duration of payment, etc.

The effective dates of the adoption assistance agreements for the case files selected for testing ranged from 1991 to 2006.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are approximately \$11,142,500.

**Cause:** The eligibility worker did not maintain or complete all required documentation supporting eligibility determinations.

**Effect:** Failure to maintain supporting documentation to support eligibility determinations resulted in noncompliance with federal grant guidelines.

**Recommendation:** DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the adoption assistance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**06-15 Maintain All Required Documentation in Child Care Case Files**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.575, Child Care and Development Block Grant  
CFDA 93.596, Child Care Mandatory and Matching Funds of the Child Care and Development Fund  
Award number: G0501HICCDF; Award year: October 1, 2004 through September 30, 2005  
Award number: G0601HICCDF; Award year: October 1, 2005 through September 30, 2006

**Criteria:** Title 45 CFR Part 98.65(e) requires appropriate documentation be maintained to allow the verification that funds are expended in accordance with statutory and regulatory requirements.

**Condition:** During our review of 30 child care case files, we noted the following:

- 2 case files were missing required documentation supporting \$2,183 in child care benefit payments. These include child care receipt and verification of service forms.
- 19 case files in which the application forms and/or other forms were missing or not properly completed.

**Questioned Costs:** \$2,183 based on the errors indicated in the condition above.

**Context:** In 2006, total federal expenditures for this program are approximately \$34,704,200.

**Cause:** The eligibility worker did not maintain or complete all required documentation supporting eligibility determinations and/or child care benefit payments to child care providers.

**Effect:** Failure to maintain supporting documentation to support eligibility determinations resulted in noncompliance with federal grant guidelines.

**Recommendation:** DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the child care payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Views of responsible officials and planned corrective action:** See Response from Affected Agency.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**

**Compliance and Internal Control Findings (continued)**

**06-16 Identify Federal Award Information and Applicable Compliance Requirements to Child Care Subrecipients**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.575, Child Care and Development Block Grant

CFDA 93.596, Child Care Mandatory and Matching Funds of the Child Care and Development Fund

Award number: G0501HICCDF; Award year: October 1, 2004 through September 30, 2005

Award number: G0601HICCDF; Award year: October 1, 2005 through September 30, 2006

**Criteria:** 31 USC 7502(f)(2)(B) and OMB Circular A-133 requires a pass-through entity to identify to the subrecipient the federal award information (e.g., CFDA title and number, award name, name of federal agency and amount of federal funds) and applicable compliance requirements at the time of the award. When some of this information is not available, the pass-through entity shall provide the best information available to describe the federal award.

**Condition:** During our review of 5 contract files and inquiry with program staff, we noted that the Federal award information and applicable compliance requirements were not identified to the subrecipients. Total federal funds paid in 2006 for the 5 contracts was approximately \$1,087,000.

We did note, however, that DHS's Management Services Offices performed subrecipient monitoring activities in accordance with applicable compliance requirements.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are approximately \$34,704,200.

**Cause:** The program was unaware of the above subrecipient monitoring requirement.

**Effect:** Failure to indicate federal award information may result in a subrecipient's noncompliance with federal award guidelines.

**Recommendation:** DHS should include the federal award information (e.g., CFDA title and number, award name, name of federal agency and amount of federal funds) and applicable compliance requirements in the subrecipient contracts to ensure Federal award information and applicable compliance requirements are identified to subrecipients at the time of the award.

**Views of the responsible official and planned corrective action:** Refer to Response of Affected Agency.

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

**06-17    Improve Accuracy of Foster Care Maintenance Payments**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.658, Foster Care – Title IV-E

Award number: 0501HI1401; Award year: October 1, 2004 through September 30, 2005

Award number: 0601HI1401; Award year: October 1, 2005 through September 30, 2006

**Criteria:** According to USC 672(b)(1) and (2), and 675(4), foster care maintenance payments may be made on behalf of eligible children to individuals serving as foster family homes.

**Condition:** During our review of 30 foster care maintenance payments, we noted the following:

- 1 instance where a child was ineligible to receive maintenance payments because a judicial determination was not made within the 180 day limit. This resulted in an overpayment of approximately \$240.
- 1 instance where a foster family was ineligible to receive maintenance payments because the foster family home was not fully licensed. This resulted in an overpayment of approximately \$9,989.
- 1 instance where an incorrect amount was paid to a foster family due to an error in the calculation on the DHS Computation of Difficulty of Care (DOC) document. This resulted in an overpayment of approximately \$4.

**Questioned Costs:** \$10, 233 based on the errors indicated in the condition above.

**Context:** In 2006, total federal expenditures for this program are \$22,665,000.

**Cause:** The findings described above are primarily due to clerical error/oversight.

**Effect:** These clerical errors resulted in overpayments of foster care maintenance payments.

**Recommendation:** We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed and foster care maintenance payments are the correct amount.

**Views of responsible officials and planned corrective action:** See Response from Affected Agency.

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**

**Compliance and Internal Control Findings (continued)**

**06-18 Maintain All Required Documentation in Foster Care Files**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.658, Foster Care – Title IV-E

Award number: 0501HI1401; Award year: October 1, 2004 through September 30, 2005

Award number: 0601HI1401; Award year: October 1, 2005 through September 30, 2006

**Criteria:** According to 42 USC 671(a)(10) and USC 672(c), the foster family home or child-care institution must be fully licensed by the proper State Foster Care licensing authority.

**Condition:** During our review of 30 foster care case files, we noted the following:

- 4 instances where the foster family home was not fully licensed. The “Certificate of Approval” (Form DHS 1591B) was not effective while the child was in the care of the foster family.
- 4 instances where the foster parent’s licensing file did not contain supporting documentation to verify a marriage.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are \$22,665,000.

**Cause:** The eligibility worker did not maintain or complete all required documentation supporting eligibility determinations.

**Effect:** Clerical errors may result in overpayment of foster care maintenance payments.

**Recommendation:** We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Views of responsible officials and planned corrective action:** See Response from Affected Agency.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

**06-19**    **Improve Controls Over Foster Care Disbursements**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.658, Foster Care – Title IV-E

Award number: 0501HI1401; Award year: October 1, 2004 through September 30, 2005

Award number: 0601HI1401; Award year: October 1, 2005 through September 30, 2006

**Criteria:** According to 45 CFR 1356.60(c), funds may be expended for costs directly related to the administration of the program, including those associated with eligibility determination and redetermination, referral to services, placement, preparation for and participation in hearing and appeals, rate setting, recruitment and licensing of foster homes and institutions, and a proportionate share of related agency overhead.

**Condition:** During our review of administrative costs charged to the program, we noted 1 instance where an unallowed expenditure was charged to the Foster Care program for a rent deposit needed in order to help a mother reunify with her children.

**Questioned Costs:** The expenditure amount for the rental deposit was \$400.

**Context:** In 2006, total federal expenditures for this program are \$22,665,000.

**Cause:** The finding described above is primarily due to clerical error/oversight.

**Effect:** This clerical error resulted in an unallowable cost charged to the program.

**Recommendation:** We recommend that program staff reevaluate existing policies and procedures to ensure that program expenditures are allowed and charged to the proper program.

**Views of responsible officials and planned corrective action:** See Response from Affected Agency.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**06-20 Monitor Social Services Block Grant Earmarking Requirements**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.667, Social Services Block Grant

Award number: G0501HISOSR; Award year: October 1, 2004 through September 30, 2006

Award number: G0601HISOSR; Award year: October 1, 2005 through September 30, 2006

**Criteria:** According to 42 USC 604(d)(3)(A), the State shall use all of the amount transferred in from the Temporary Assistance for Needy Families grant (CFDA #93.558) only for programs and services to children or their families whose income is less than 200 percent of the official poverty guideline.

**Condition:** Per review of the "Report of Intended Use", the State will use the TANF transfer to provide contracted services to families served by the State's child welfare/child protective services program. However, the State does not specifically monitor these contracts to ensure that programs or services are only provided to children or families whose income is less than 200 percent of the federal poverty guidelines. Total aggregate federal funds transferred from TANF in 2006 was approximately \$9,832,600.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are \$19,601,000.

**Cause:** The program has not assigned priority to monitoring earmarking requirements.

**Effect:** There is no assurance that program funds are being used in accordance with Federal laws and regulations.

**Recommendation:** We recommend that the program evaluate and modify these agreements to include a requirement to provide programs or services to children or families that meet federal poverty guidelines in order to comply with earmarking requirements. In addition, we recommend that the program implement monitoring procedures and reporting requirements to ensure each contractor is in compliance with earmarking requirements.

**Views of responsible officials and planned corrective action:** See Response from Affected Agency.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**06-21 Maintain All Required Documentation in SCHIP Case Files**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.767, State Children's Insurance Program (SCHIP)

Award number: 05-0505HI5021; Award year: October 1, 2004 through September 30, 2005

Award number: 05-0605HI5021; Award year: October 1, 2005 through September 30, 2006

**Criteria:** According to 42 USC 1397bb(b), States are required to include in their State Plans a description of the standards used to determine eligibility of targeted low-income children. According to the Title XXI State Plan (dated October 19, 1998) and the State Plan Amendment TN No. 00-003 (dated January 11, 2000), individuals under age 19 must be a US citizen, qualified immigrant, or legal immigrant.

**Condition:** During our review of 30 SCHIP case files, we noted 1 instance where the case file did not have appropriate documentation to verify birth date or US citizenship.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are \$12,147,000.

**Cause:** The eligibility worker did not maintain or complete all required documentation supporting eligibility determinations.

**Effect:** Clerical errors may result in overpayments of child health assistance.

**Recommendation:** We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the eligibility of individuals who receive child health assistance. A secondary review would help to ensure all required documents are properly completed.

**Views of responsible officials and planned corrective action:** See Response from Affected Agency.

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**

**Compliance and Internal Control Findings (continued)**

**06-22 Identify Federal Award Information and Applicable Compliance Requirements to Food Stamp Subrecipients**

Federal Agency: U.S. Department of Agriculture (USDA), Food and Nutrition Service (FNS)  
CFDA 10.551 and 10.561, Food Stamp Cluster

Award number: 7HI400HI4; Award year: October 1, 2004 through September 30, 2005

Award number: 7HI400HI4; Award year: October 1, 2005 through September 30, 2006

**Criteria:** 31 USC 7502(f)(2)(B) and OMB Circular A-133 requires a pass-through entity to identify to the subrecipient the federal award information (e.g., CFDA title and number, award name, name of federal agency and amount of federal funds) and applicable compliance requirements at the time of the award. When some of this information is not available, the pass-through entity shall provide the best information available to describe the federal award.

**Condition:** During our review of 3 contract files and inquiry with program staff, we noted that the Federal award information and applicable compliance requirements were not identified to the subrecipients. Total federal funds paid in 2006 for the 3 contracts was approximately \$335,300.

We did note, however, that DHS's Management Services Offices performed subrecipient monitoring activities in accordance with applicable compliance requirements.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are approximately \$160,754,700.

**Cause:** The program was unaware of the above subrecipient monitoring requirement.

**Effect:** Failure to indicate federal award information may result in a subrecipient's noncompliance with federal award guidelines.

**Recommendation:** DHS should include the federal award information (e.g., CFDA title and number, award name, name of federal agency and amount of federal funds) and applicable compliance requirements in the subrecipient contracts to ensure Federal award information and applicable compliance requirements are identified to subrecipients at the time of the award.

**Views of the responsible official and planned corrective action:** Refer to Response of Affected Agency.

Department of Human Services  
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

**06-23**    **Maintain Adequate Security over EBT Cards**

Federal Agency: U.S. Department of Agriculture (USDA), Food and Nutrition Service (FNS)

CFDA: 10.551 and 10.561, Food Stamp Cluster

Award number: 7HI400HI4; Award year: October 1, 2004 through September 30, 2005

Award number: 7HI400HI4; Award year: October 1, 2005 through September 30, 2006

**Criteria:** The State is required to maintain adequate security over, and documentation/records for, Authorization to Participate (ATP) cards, other documents authorizing issuance, EBT cards (7 CFR Section 274.12(h)(3)), and the food stamp coupons themselves to prevent: coupon theft, embezzlement, loss, damage, destruction; unauthorized transfer, negotiation, or use of coupons; and alteration or counterfeiting of coupons and other documents authorizing issuance (7 CFR Sections 274.7(b) and 274.11(c))

**Condition:** We visited 5 of the 45 units issuing EBT cards to review controls surrounding security over EBT cards. We noted 3 of the 5 units were not adhering to the policies and procedures for maintaining adequate security over EBT cards. The following findings were noted:

- Bulk EBT Card Inventory Record Forms were not completed or maintained.
- Issuance Logs for blank EBT cards were not properly completed.
- Daily audits of the working supply were not performed by the unit supervisors.
- Weekly/monthly audits of the bulk inventory supply (i.e., physical counts) were not performed by the unit supervisors.

We did note, however, that the three units started completing the Bulk EBT Card Inventory Record Forms subsequent to the period of our review.

**Questioned Costs:** We identified no questioned costs in our tests of compliance with this requirement.

**Context:** In 2006, total federal expenditures for this program are approximately \$160,754,700.

**Cause:** Due to changes in personnel over the years, some of the units were not aware of the policies and procedures over EBT cards.

**Effect:** Failure to maintain adequate security over EBT cards resulted in noncompliance with federal grant guidelines.

**Recommendation:** We recommend that program adhere to the policies and procedures for maintaining adequate security over EBT cards to prevent loss or theft.

**Views of the responsible official and planned corrective actions:** Refer to Response of Affected Agency.

**PART V**

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Year ended June 30, 2006

This section contains the current status of prior audit recommendations. The recommendations are referenced to the pages of the previous audit report for the year ended June 30, 2005, dated March 1, 2006.

**Ref.**

**no. Internal Control Findings**

**05-1 Properly Record All Fixed Assets in the State Property Inventory Records (page 55)**

Divisions within the DHS are responsible for reporting the acquisition and disposal of fixed assets to the State Procurement Office on a quarterly basis to update the state property inventory records.

Section 103D-106 of the Hawaii Revised Statutes states in part, "...the administrative heads of the executive departments, and all other persons, offices, and boards of a public character...shall prepare and file with the administrator of the state procurement office an annual inventory return of state property in the possession, custody, control, or use of the officer making the return, or of the department or office of the government over which the officer presides...."

Although the DHS has implemented stricter departmental inventory procedures to properly report fixed asset purchases to the State Procurement Office, personnel did not always adhere to the established procedures.

The Department of Accounting and General Services (DAGS) uses the information from the state property inventory records to assist the DHS in compiling the department's fixed assets and depreciation information for the year. Based on this information, we noted the following conditions:

- The DHS changed the carrying value of items that were acquired in previous years to correctly state the cost of the assets. There were several instances where the items' carrying value was corrected with a net change to the fixed asset listing of \$(709,931).

The finding described above was primarily due to clerical error/oversight.

- There were several instances where the DHS did not perform inventory procedures on furniture and equipment items, resulting in an understatement to the fixed asset listing of \$(558,179).

The finding described above was due to a misunderstanding of whether the purchasing unit or the unit that maintains the items was responsible for performing inventory procedures.

- The State Department of Accounting and General Services (DAGS) Public Works Division is responsible for managing the capital improvement projects at the DHS's Office of Youth Services (OYS). The funding for these projects is budgeted for under the DAGS. The DAGS provides the OYS with a report on a monthly basis that includes the total expenditures incurred and the remaining allotment and encumbrance balances, by project, as of the month end. When the encumbrance balance for a project has been totally expended, the project has been completed and should be added to inventory. The OYS added Hawaii Youth Correctional Facility (HYCF) building and land improvement

Department of Human Services  
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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Year ended June 30, 2006

**Ref.  
no.**

**Internal Control Findings (continued)**

projects that were completed in prior years totaling \$2,430,266 to inventory. This resulted in an understatement to the fixed asset listing in prior years.

The finding described above was due to the oversight of the employee responsible for performing the inventory procedures.

**Recommendation**

To ensure that the state property inventory records are complete and accurate, the DHS should implement monitoring procedures to ensure that all appropriate personnel properly and accurately report all fixed asset acquisitions and dispositions to the State Procurement Office on a quarterly basis. The DHS should implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that the transactions were properly posted to the state property inventory records. The DHS's Property and Procurement Office issued an internal communication memorandum in November 2005 stating the purchasing unit of fixed asset items should be responsible for performing inventory procedures unless otherwise agreed upon.

**Status**

Not accomplished. See Reference No. 06-1.

**05-2 Maintain Vacation and Sick Leave Records Properly (page 56)**

The DHS prepared a summary leave schedule to determine the amount of its accrued compensated absences liability and reported the liability to the State Comptroller. The liability was based on the balance of earned hours per individual leave records (Form DPS-7) multiplied by each employee's hourly salary rate. During our review of 44 leave records and one month of Form G-1, *Application for Leave of Absence*, we noted the following conditions:

- There were 9 instances where the accrued vacation leave hours on the summary leave schedule did not agree to the individual Form DPS-7. This resulted in an overstatement of accrued vacation leave totaling 140 hours or \$2,712.
- There were 5 instances where the accumulated sick leave hours on the summary leave schedule did not agree to the individual Form DPS-7. This resulted in an understatement and overstatement of accumulated sick leave totaling (11) hours or \$330, respectively.
- There was 1 instance where the accrued compensatory time hours on the summary leave schedule did not agree to the individual Form DPS-7. This resulted in an understatement of accrued compensatory time totaling (1) hour or \$(25).

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Year ended June 30, 2006

**Ref.  
no.**

**Internal Control Findings (continued)**

- There was 1 instance where an employee's accrued vacation leave hours carried forward from their 2004 to 2005 leave record exceeded the 720 hour limit. This resulted in an overstatement of accrued vacation leave totaling 20 hours or \$539.
- There were 23 instances where the Form G-1, *Application for Leave of Absence*, was authorized after the employee took vacation.
- There was 1 instance where there was no supervisor approval indicated on the Form G-1, *Application for Leave of Absence*.
- There were 2 instances where there was no supervisor approval date indicated on the Form G-1, *Application for Leave of Absence*.

The findings described above are primarily due to clerical error/oversight.

Although the DHS established procedures to conduct secondary reviews and random quality control reviews of leave records, it appears that the leave records were not always updated accurately on a timely basis.

**Recommendation**

We recognize that approvals of vacation could occur after the fact, such as when an employee must care for a dependent who becomes ill the night before. In those instances, we recommend that the employee's record be annotated to reflect that telephonic approval was given.

The DHS should increase the number of random quality control reviews of leave records and perform them periodically throughout the year to ensure that vacation and sick leave and compensatory time records are accurately maintained and reviewed on a timely basis. The reviews should include ensuring that there is a secondary review performed on the leave records by the supervisor of the employee responsible for maintaining the records. In addition, a secondary review of the summary leave schedule should be performed before reporting the balances to the State Comptroller, including ensuring that the beginning balances are correct.

**Status**

Not accomplished. See Reference No. 06-2.

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**    **Compliance and Internal Control Findings**

**05-3    Allocate Costs Properly (page 58)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.558, Temporary Assistance to Needy Families (TANF)

The DHS prepares a departmental cost allocation on a quarterly basis which allocates costs that are not directly chargeable to one specific program based on allocation methods contained in its cost allocation plan which is approved by the Director of the U.S. Department of Health and Human Services Division of Cost Allocation.

In accordance with DHS's approved cost allocation plan, the DHS allocates costs incurred by the Management Services Office (MSO) Quality Control (QC) unit based on the actual number of cases worked on, by program, for the quarter. The supervisor of the MSO QC unit prepares a memorandum which summarizes the percentage of cases worked on, by program, for the cost allocation accountant to allocate the costs accordingly.

During our review of the quarter end December 31, 2004 cost allocation, we noted costs incurred by the MSO QC unit totaling \$21,087 was erroneously charged to the TANF grant. The finding was due to the misunderstanding of the proper grant to charge by the MSO QC supervisor.

**Recommendation**

To ensure that the costs contained in the DHS's departmental cost allocation are allocated properly, all employees responsible for preparing supporting cost allocation documents should seek guidance regarding the proper grant to charge if they are unsure. The error was corrected on the quarter end September 30, 2005 and December 31, 2005 cost allocations.

**Status**

Accomplished.

**05-4    Improve Utilization Controls over Medicaid Claims**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

The Hawaii Prepaid Medical Management Information System (HPMMIS) was implemented and is being operated and maintained by the Arizona Health Care Cost Containment System (AHCCCS). In addition, the management and processing of pharmacy benefits was contracted to Affiliated Computer Services (ACS).

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

As discussed in the prior year's auditors' report, the HPMMIS was not able to produce the Surveillance and Utilization Review reports. In addition, post payment reviews of electronic media claims was not being performed and the use of a third party healthcare auditing and consulting company to audit the pharmacy benefits manager's operations was discontinued.

Due to the complexity of the Medicaid processing function and the large volume of Medicaid transactions, it is imperative for DHS to obtain these necessary HPMMIS reports to ensure compliance with federal regulations.

Based on our discussion with DHS personnel, we noted that DHS has been working with AHCCCS on obtaining these necessary HPMMIS reports. Meanwhile, the MQD continues to review claims payment on an ad hoc basis when payment issues are reported by DHS staff, ACS staff or providers.

**Recommendation**

DHS should obtain the necessary HPMMIS management reports to allow post payment review of recipient utilization and provider service profiles and exception criteria based on parameters set by the MQD.

**Status**

Not accomplished. See Reference No. 06-6.

**05-5 Improve Accuracy of Medicaid Claims Processing (page 59)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Due to the complexity of the Medicaid processing function and the large volume of Medicaid transactions, it is imperative for DHS to perform regular post payment reviews on sample claims to detect processing errors and identify ways to improve the claims processing systems and procedures.

During our review of 120 claims (60 drug and 60 non-drug), we noted the following:

- 2 drug claims in which there was an aggregate overpayment of \$21,287.

DHS contracted Heritage Information Systems, Inc. to perform pharmacy claims audits. The audit results will be used to correct and collect overpayments made by the ACS pharmacy benefits manager.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**Recommendation**

DHS should perform regular post payment reviews on a sample of claims to detect processing errors and identify ways to improve the claims processing system and procedures.

**Status**

Not accomplished. See Reference No. 06-7.

**05-6 Improve Controls over the Medicaid Drug Rebate Program (page 60)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

The Centers for Medicare and Medicaid (CMS) program release No. 29 requires that interest must be collected and cannot be disregarded as part of the dispute resolution process by either the manufacturer or the State. CMS program release No. 65 further clarifies that although the obligation for calculating the interests due to the States on late rebate payments rests with the manufacturer, it is the State's responsibility to track the collection of interest due, and report those amounts to CMS.

Med-Quest Division (MQD) contracts with Affiliated Computer Services, Inc. (ACS) to perform the daily operations of the drug rebate program including billing, collection, accounting and dispute resolution. On a quarterly basis, the MQD reports the drug rebate collections including any interest received on Form CMS 64.9R. This amount is used to reduce the amount to be reimbursed by the federal agency for the federal share of expenditures for the Medicaid Program. As discussed in prior year's audit, the MQD did not have adequate controls to verify if rebate interest payments were collected. During our review of the drug rebate collection supporting schedules, we noted only minimal voluntary interest being collected. As a result, the federal agency may be overcharged for the federal share of expenditures.

**Recommendation**

DHS should establish procedures to monitor their subcontractor to ensure rebate interest payments are collected and not disregarded as part of the dispute resolution process by either the manufacturer or the DHS.

**Status**

Not accomplished. See Reference No. 06-8.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**05-7 Maintain All Required Documentation in Medicaid Case Files (page 60)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

During our review of 40 case files, we noted 7 case files in which application, renewal and/or eligibility determination forms were missing or not properly completed.

Often a lack of time and resources as well as clerical error/oversight have contributed to the findings described above. In addition, we also noted a higher priority is placed on updating the information in the database rather than completing the forms in the case files.

**Recommendation**

DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the medical assistance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Status**

Not accomplished. See Reference No. 06-9.

**05-8 Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner (page 61)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Title 42 CFR Part 435.911 requires the determination of eligibility to be made within 45 days from the date of application for all applicants except for applications made on the basis of disability in which it is 60 days. In order to reduce the backlog of applications, the DHS MQD Eligibility Branch (EB) adopted policies of presumptive eligibility and client self-declaration.

Presumptive eligibility requires that applicants receive services if a decision on eligibility has not been made within the above specified timeframe. Self-declaration requires eligibility determinations to be based on the information provided on the application form. Self-declared information is supposed to be verified by the

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref. no. Compliance and Internal Control Findings (continued)**

EB whenever possible; however, such verification is often not performed until the annual eligibility review for redetermination.

While these procedural changes have reduced the backlog of outstanding applications, they have increased the likelihood that ineligible persons may be receiving benefits and also placed more reliance on subsequent eligibility re-verifications to verify clients remain eligible to receive benefits.

During our review of 40 case files, we noted 1 case file in which the redetermination was not made in a timely manner.

As of June 30, 2005, we found approximately 675 applications outstanding greater than 45 days for the MQD. In addition, the number of overdue annual re-verifications for MQD was approximately 1004 as of June 30, 2005. While the number of applications outstanding greater than 45 days decreased, the number of overdue annual re-verifications for MQD increased. Staffing problems continue to contribute to the backlog of applications, pending eligibility determinations, and overdue annual re-verifications.

In June 2004, the EB introduced passive renewals for families with children in an attempt to reduce the number of overdue annual re-verifications, however, the number of overdue annual re-verifications for MQD as of June 30, 2005 increased compared to the prior year.

**Recommendation**

DHS should assess the staffing needs at the EB and make every effort to ensure each unit is fully staffed with trained personnel in order to timely process applications and perform annual re-verifications. Adequate staffing would likely reduce the backlog of applications, pending eligibility determinations, and overdue annual re-verifications and also minimize the risk that ineligible recipients are receiving Medicaid benefits.

**Status**

Not accomplished. See Reference No. 06-10.

**05-9 Maintain All Required Provider Documentation (page 62)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

In order to participate in the Medicaid program, providers are required to have a current and valid written agreement on file with MQD except for providers for the Social Services Division and State of Hawaii Department of Health, Adult Mental Health Division which use contracts in place of provider agreements. A completed and signed Provider Information Form (Form 1139) constitutes the full written agreement.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**

**Compliance and Internal Control Findings (continued)**

Title 42 CFR part 455, subpart B also requires providers to make certain required disclosures to the State. These required disclosures are included in the Provider Information Form and contracts.

In our review of 32 MQD provider files, we noted the following:

- 1 case where the provider agreement was not present.
- 5 cases where the supplemental attachments of the provider agreements were not signed.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

DHS should ensure all provider agreements are properly completed and maintained.

**Status**

Not accomplished. See Reference No. 06-11.

**05-10 Maintain All Required Documentation in Adoption Assistance Case Files (page 62)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.659, Adoption Assistance (Title IV-E)

During our review of 30 case files, we noted 13 case files in which required forms were missing or not properly completed including the amount, duration of payment, etc.

The findings described above are primarily due to clerical error/oversight.

The effective dates of the adoption assistance agreements for the case files selected for testing ranged from 1995 to 2005.

**Recommendation**

DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the adoption assistance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Status**

Not accomplished. See Reference No. 06-14.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**05-11 Maintain All Required Documentation in Child Care Case Files (page 63)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.575, Child Care and Development Block Grant  
CFDA 93.596, Child Care Mandatory and Matching Funds of the Child Care and Development Fund

During our review of 40 case files, we noted the following:

- 2 case files were missing required documentation supporting eligibility determinations. These include children's birth certificates, baptismal or hospital certificates, or court decree.
- 2 case files were missing required documentation supporting \$576 in child care benefit payments. These include child care receipt and verification of service forms.
- 8 case files in which redeterminations were not made in a timely manner.
- In addition, we also noted several case files in which the application forms and/or other forms were missing or not properly completed.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the child care payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Status**

Not accomplished. See Reference No. 06-15.

**05-12 Ensure All Subrecipients are Identified for Subrecipient Monitoring (page 63)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.575, Child Care and Development Block Grant  
CFDA 93.596, Child Care Mandatory and Matching Funds of the Child Care and Development Fund

OMB Circular A-133 provides guidance to grantees who provide funds to subrecipients. Section 210 of the circular also provides guidance in assisting grantees in differentiating between a subrecipient and a vendor.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

In October of each year, the department's Management Services Office (MSO) sends a memo to the divisions requesting a list of subrecipients that were contracted during the previous year. The listing is used to identify the subrecipients for monitoring purposes.

During the prior-year audit, we noted that while MSO performed subrecipient monitoring for the different programs, no monitoring was done in 2004 on any of the subrecipients who received Child Care funds in 2003. Upon inquiry, we were informed that the program had not provided the names of these entities to the MSO because the program had considered the entities to be vendors and not subrecipients.

We recommended that the program seek guidance from the federal cognizant agency, oversight agency or the federal awarding agency as to the attributes of a subrecipient versus a vendor relationship as they relate to this specific program. Once such guidance is received, the program should evaluate each of its agreements and document the rationale for its decision.

In October 2005, the program received guidance from the Federal Agency indicating that they would consider the providers under the program's service agreements to be subrecipients. Accordingly, the program will consider these providers to be subrecipients in future contracts and supplemental agreements and comply with the applicable subrecipient monitoring requirements prospectively.

**Recommendation**

We recommend that the program evaluate each of its agreements, document the rationale for its decision and provide the names of the entities determined to be subrecipients to MSO to perform subrecipient monitoring in order to comply with the subrecipient monitoring requirements.

**Status**

Partially accomplished. See Reference No. 06-16.

**05-13 Improve the Accuracy of Reports (page 64)**

Federal agency: Social Security Administration  
CFDA 96.001, Social Security – Disability Insurance (DI)

According to POMS DI 36506.230, the Form SSA-4514, Time Report of Personnel Services, is due quarterly to account for employee time. During our review of the quarterly reports, we noted that 2 out of 4 reports submitted during the year presented incorrect information.

- One report included additional overtime hours.
- One report did not include additional overtime hours as provided for in supporting documents.

The findings described above are primarily due to clerical error/oversight.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**Recommendation**

We recommend that DHS implement review procedures to ensure that information presented on required reports is complete and accurate before it is submitted to the Federal oversight agency.

**Status**

Accomplished.

**05-14 Improve Accuracy of Foster Care Maintenance Payments (page 65)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.658, Foster Care – Title IV-E

According to USC 672(b)(1) and (2), and 675(4), Foster Care maintenance payments may be made on behalf of eligible children to individuals serving as foster family homes. During our review of 40 Foster Care maintenance payments, we noted the following:

- 1 instance where an incorrect amount was paid to foster parents.
- 1 instance where the maintenance payments were not supported by required documentation.
- 1 instance of an overclaim for maintenance payments.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed and foster care maintenance payments are the correct amount.

**Status**

Not accomplished. See Reference No. 06-17.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**

**Compliance and Internal Control Findings (continued)**

**05-15 Maintain All Required Documentation in Foster Care Files (page 65)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.658, Foster Care – Title IV-E

According to 42 USC 672(a), the child must meet the eligibility requirements of the former Aid to Families with Dependent Children (AFDC) program. To meet this requirement, the Department uses Form DHS 1577D, "Certification of Initial Eligibility for Title IV-E Foster Care," to document eligibility determinations. During our review of 40 Foster Care files, we noted 1 instance in which the Form 1577D was not properly completed as there was no indication if the child was deprived of parental support or care. In addition, we also noted that the foster parent's licensing file did not contain supporting documentation to verify a marriage. According to 45 CFR 1356.30(a) and (b), the foster family home provider must have satisfactorily met a criminal records check.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Status**

Not accomplished. See Reference No. 06-18.

**05-16 Maintain All Required Documentation in Case Files (page 66)**

Federal agency: U.S. Department of Education  
CFDA 84.126, Rehabilitation Services – Vocation Rehabilitation Grants to States

According to 29 USC 722(a)(3), an individual who is a beneficiary of Social Security Disability Insurance (SSDI) or Supplemental Security Income (SSI) is presumed to be eligible for vocational rehabilitation services. During our review of 30 case files, we noted 6 instances where the case files did not contain proper supporting documentation to confirm whether the individuals were recipients of SSDI or SSI, but they were determined to be eligible.

The findings described above are primarily due to clerical error/oversight.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**Recommendation**

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the eligibility of the individuals who are provided with vocational rehabilitation services. A secondary review would help to ensure all required documents are properly completed.

**Status**

Accomplished.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

This section contains the current status of prior audit recommendations. The recommendations are referenced to the pages of the previous audit report for the fiscal year ended June 30, 2004, dated April 14, 2005.

**Ref.**

**no. Internal Control Findings**

**04-1 Properly Record All Fixed Assets in the State Property Inventory Records (page 54)**

Divisions within the DHS are responsible for reporting the acquisition and disposal of fixed assets to the State Procurement Office on a quarterly basis to update the state property inventory records.

Section 103D-106 of the Hawaii Revised Statutes states in part, "...the administrative heads of the executive departments, and all other persons, offices, and boards of a public character...shall prepare and file with the administrator of the state procurement office an annual inventory return of state property in the possession, custody, control, or use of the officer making the return, or of the department or office of the government over which the officer presides...."

Although the DHS has issued reminders to all division offices to properly report fixed asset purchases to the State Procurement Office, personnel did not always adhere to the established procedures.

The Department of Accounting and General Services (DAGS) uses the information from the state property inventory records to assist the DHS in compiling the department's fixed assets and depreciation information for the year. We noted that during the current year, the DHS changed the carrying value of items that were acquired in previous years to correctly state the cost of the assets.

We noted several instances where the items' carrying value was corrected with a net change to the fixed asset listing of approximately \$82,000.

**Recommendation**

To ensure that the state property inventory records are complete and accurate, the DHS should implement monitoring procedures to ensure that all appropriate personnel properly and accurately report all fixed asset acquisitions and dispositions to the State Procurement Office on a quarterly basis. The DHS should also implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that the transactions were properly posted to the state property inventory records.

**Status**

Not accomplished. See reference No. 06-1.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Internal Control Findings (continued)**

**04-2 Maintain Vacation and Sick Leave Records Properly (page 55)**

The DHS prepared a summary leave schedule to determine the amount of its accrued compensated absences liability and reported the liability to the State Comptroller. The liability was based on the balance of earned hours per individual leave records (Form DPS-7) multiplied by each employee's hourly salary rate. We noted the following conditions:

- There were numerous instances where the Form G-1, *Application for Leave of Absence*, was authorized after the employee took vacation.
- There were numerous instances where the accrued vacation and sick leave hours on the summary leave schedule did not agree to the individual Form DPS-7.
- There were two instances where sick leave taken and approved on Form G-1, *Application for Leave of Absence*, was not recorded on the employee's Form DPS-7. This resulted in an overstatement of sick leave totaling 59 hours or \$1,136.

Although the DHS established procedures to conduct secondary reviews and random quality control reviews of leave records, it appears that the leave records were not always updated accurately on a timely basis.

**Recommendation**

We recognize that approvals of vacation could occur after the fact, such as when an employee must care for a dependent who becomes ill the night before. In those instances, we recommend that the employee's record be annotated to reflect that telephonic approval was given.

The DHS should increase the number of random quality control reviews of leave records to ensure that vacation and sick leave records are accurately maintained and reviewed on a timely basis. In addition, a secondary review of the summary leave schedule should be performed before reporting the balances to the State Comptroller.

**Status**

Not accomplished. See reference No. 06-2.

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Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings**

**04-3 Improve Utilization Controls over Medicaid Claims (page 56)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

In the prior year, the Hawaii Prepaid Medical Management Information System (HPMMIS) was implemented and is being operated and maintained by the Arizona Health Care Cost Containment System (AHCCCS). In addition, the management and processing of pharmacy benefits was contracted to Affiliated Computer Services (ACS).

As discussed in the prior year's auditors' report, the HPMMIS was not able to produce the Surveillance and Utilization Review reports. In addition, post payment reviews of electronic media claims was not being performed and the use of a third party healthcare auditing and consulting company to audit the pharmacy benefits manager's operations was discontinued.

Due to the complexity of the Medicaid processing function and the large volume of Medicaid transactions, it is imperative for DHS to obtain these necessary HPMMIS reports to ensure compliance with federal regulations.

Based on our discussion with DHS personnel, we noted that DHS has been working with AHCCCS on obtaining these necessary HPMMIS reports. Meanwhile, the MQD continues to review claims payment on an ad hoc basis when payment issues are reported by DHS staff, ACS staff or providers.

**Recommendation**

DHS should obtain the necessary HPMMIS management reports to allow post payment review of recipient utilization and provider service profiles and exception criteria based on parameters set by the MQD.

**Status**

Not accomplished. See reference No. 06-6.

**04-4 Improve Accuracy of Medicaid Claims Processing (pages 56-57)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

Due to the complexity of the Medicaid processing function and the large volume of Medicaid transactions, it imperative for DHS to perform regular post payment reviews on sample claims to detect processing errors and identify ways to improve the claims processing systems and procedures.

During our review of 120 claims (60 drug and 60 non-drug), we noted the following:

- 5 non-drug claims in which there was a net aggregate overpayment of \$7,586. Approximately \$5,100 was related to a nursing facility services claim in which there was no prior authorization for the specified period. There was authorization for the periods prior and subsequent to the specified period.

DHS contracted Heritage Information Systems, Inc. to perform pharmacy claims audits. The audit results will be used to correct and collect overpayments made by the ACS pharmacy benefit manager.

**Recommendation**

DHS should perform regular post payment reviews on a sample of claims to detect processing errors and identify ways to improve the claims processing system and procedures.

**Status**

Not accomplished. See reference No. 06-7.

**04-6 Improve Controls over the Medicaid Drug Rebate Program (page 58)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

The Centers for Medicare and Medicaid (CMS) program release No. 29 requires that interest must be collected and cannot be disregarded as part of the dispute resolution process by either the manufacturer or the State. CMS program release No. 65 further clarifies that although the obligation for calculating the interests due to the States on late rebate payments rests with the manufacturer, it is the State's responsibility to track the collection of interest due, and report those amounts to CMS.

Med-Quest Division (MQD) contracts with Affiliated Computer Services, Inc. (ACS) to perform the daily operations of the drug rebate program including billing, collection, accounting and dispute resolution. On a quarterly basis, the MQD reports the drug rebate collections including any interest received on Form CMS 64.9R. This amount is used to reduce the amount to be reimbursed by the federal agency for the federal share of expenditures for the Medicaid Program. MQD did not have adequate controls to verify if rebate interest payments were collected. During our review of the ACS Drug Rebate reports, we noted only minimal

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**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

voluntary interest being collected. As a result, the federal agency may be overcharged for the federal share of expenditures.

In a report dated July 28, 2003, the U.S. Department of Health and Human Services, Office of the Inspector General reported similar findings and recommendations from an audit of the Hawaii Medicaid Drug Rebate program for the year ended June 30, 2002.

We also noted a section regarding the calculation of interest on disputed or unpaid amounts and late drug rebate payments in ACS's Drug Rebate Policies and Procedures dated March 2005.

**Recommendation**

DHS should ensure rebate interest payments are collected and not disregarded as part of the dispute resolution process by either the manufacturer or the DHS.

**Status**

Not accomplished. See reference No. 06-8.

**04-7 Maintain All Required Documentation in Medicaid Case Files (pages 58-59)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

During our review of 30 case files, we noted 17 case files in which application, renewal and/or eligibility determination forms were missing or not properly completed.

Often a lack of time and resources as well as clerical error/oversight have contributed to the findings described above. In addition, we also noted a higher priority is placed on updating the information in the database rather than completing the forms in the case files.

**Recommendation**

DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the medical assistance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Status**

Not accomplished. See reference No. 06-9.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**04-8 Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner (pages 59-60)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Title 42 CFR Part 435.911 requires the determination of eligibility to be made within 45 days from the date of application for all applicants except for applications made on the basis of disability in which it is 60 days. In order to reduce the backlog of applications, the DHS MQD Eligibility Branch (EB) adopted policies of presumptive eligibility and client self-declaration.

Presumptive eligibility requires that applicants receive services if a decision on eligibility has not been made within the above specified timeframe. Self-declaration requires eligibility determinations to be based on the information provided on the application form. Self-declared information is supposed to be verified by the EB whenever possible; however, such verification is often not performed until the annual eligibility review for redetermination.

While these procedural changes have reduced the backlog of outstanding applications, they have increased the likelihood that ineligible persons may be receiving benefits and also placed more reliance on subsequent eligibility re-verifications to verify clients remain eligible to receive benefits.

During our review of 30 case files, we noted 4 case files in which redeterminations were not made in a timely manner.

As of June 30, 2004, we found approximately 760 applications outstanding greater than 45 days. In addition, the number of overdue annual re-verifications for MQD was approximately 850 as of June 30, 2004. Staffing problems continue to contribute to the backlog of applications, pending eligibility determinations, and overdue annual re-verifications.

In June 2004, the EB introduced passive renewals for families with children in an attempt to reduce the number of overdue annual re-verifications.

**Recommendation**

DHS should assess the staffing needs at the EB and make every effort to ensure each unit is fully staffed with trained personnel in order to timely process applications and perform annual re-verifications. Adequate staffing would likely reduce the backlog of applications, pending eligibility determinations, and overdue annual re-verifications and also minimize the risk that ineligible recipients are receiving Medicaid benefits.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**Status**

Not accomplished. See reference No. 06-10.

**04-9 Maintain All Required Provider Documentation (page 60)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

In order to participate in the Medicaid program, providers are required to have a current and valid written agreement on file with MQD except for providers for the Social Services Division which uses contracts in place of provider agreements. A completed and signed Provider Information Form (Form 1139) constitutes the full written agreement. Title 42 CFR part 455, subpart B also requires providers to make certain required disclosures to the State. These required disclosures are included in the Provider Information Form and contracts.

In our review of 32 provider files, we noted the following:

- 3 cases where the provider agreement was not present
- 1 case where the provider agreement was not signed

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

DHS should ensure all provider agreements are properly completed and maintained.

**Status**

Not accomplished. See reference No. 06-11.

**04-10 Maintain All Required Documentation in Adoption Assistance Case Files (pages 60-61)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.659, Adoption Assistance (Title IV-E)

During our review of 30 case files, we noted several case files in which required forms were missing or not properly completed including the amount, duration of payment, authorizing signature, etc.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

The findings described above are primarily due to clerical error/oversight.

The effective dates of the adoption assistance agreements for the case files selected for testing ranged from 1991 to 2003.

**Recommendation**

DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the adoption assistance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Status**

Not accomplished. See reference No. 06-14.

**04-11 Maintain All Required Documentation in Child Care Case Files (page 61)**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.575, Child Care and Development Block Grant

CFDA 93.596, Child Care Mandatory and Matching Funds of the Child Care and Development Fund

During our review of 30 case files, we noted the following:

- 5 case files were missing required documentation supporting \$1,621 in child care benefit payments. These include child care receipt and verification of service forms.
- 9 case files in which redeterminations were not made in a timely manner.
- In addition, we also noted several case files in which the application forms and/or other forms were missing or not properly completed.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the child care payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**Status**

Not accomplished. See reference No. 06-15.

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State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2006

**Ref.**  
**no.**

**Compliance and Internal Control Findings (continued)**

**04-13 Ensure All Subrecipients are Identified for Subrecipient Monitoring (page 62)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.575, Child Care and Development Block Grant

CFDA 93.596, Child Care Mandatory and Matching Funds of the Child Care and Development Fund

OMB Circular A-133 provides guidance to grantees who provide funds to subrecipients. Section 210 of the circular also provides guidance in assisting grantees in differentiating between a subrecipient and a vendor.

In October of each year, the department's Management Services Office (MSO) sends a memo to the divisions requesting a list of subrecipients that were contracted during the previous year. The listing is used to identify the subrecipients for monitoring purposes.

While MSO performs subrecipient monitoring for the different programs, no monitoring was done in 2004 on any of the subrecipients who received Child Care funds in 2003. Our review of MSO's list of 2003 subrecipients did not disclose any subrecipients relating to the Child Care program.

However, our discussion with the Child Care program accountant indicated that there were several not-for-profit and governmental organizations that did receive funds in 2003 and provided services for the program.

Upon inquiry, we were informed that the program had not provided the names of these entities to the MSO because the program had considered the entities to be vendors and not subrecipients.

**Recommendation**

We recommend that the program seek guidance from the federal cognizant agency, oversight agency or the federal awarding agency as to the attributes of a subrecipient versus a vendor relationship as they relate to this specific program. Once such guidance is received, the program should evaluate each of its agreements and document the rationale for its decision.

**Status**

Not accomplished. See reference No. 06-16.

**PART VI**  
**RESPONSE OF THE AFFECTED AGENCY**

LINDA LINGLE  
GOVERNOR



LILLIAN B. KOLLER, ESQ.  
DIRECTOR

HENRY OLIVA  
DEPUTY DIRECTOR

STATE OF HAWAII  
DEPARTMENT OF HUMAN SERVICES  
P. O. Box 339  
Honolulu, Hawaii 96809

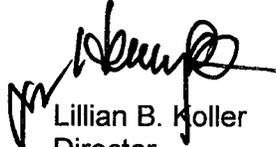
August 10, 2007

Mr. Howard Hanada  
Grant Thornton LLP  
1132 Bishop Street, Suite 1000  
Honolulu, Hawaii 96813

Dear Mr. Hanada:

Attached are the Department of Human Services' responses and corrective action plans related to your fiscal year 2006 audit report findings and recommendations. We appreciate the opportunity to comment on the audit report.

Sincerely,



Lillian B. Koller  
Director

Attachment

**Ref. no. 06-1:**

**Properly Record All Fixed Assets in the State Property Inventory Records**

**Auditor's Recommendation:**

To ensure that the state property inventory records are complete and accurate, the DHS should implement monitoring procedures to ensure that all appropriate personnel properly and accurately report all fixed asset acquisitions and dispositions to the State Procurement Office on a quarterly basis. The DHS should implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that the transactions were properly posted to the state property inventory records.

**Corrective Action Taken or Planned:**

In March 2003, stricter departmental inventory procedures were issued establishing each employee as being responsible and accountable for maintaining and safeguarding inventory assigned to the individual. In addition, property custodians are assigned to each office/unit and are responsible for fixed assets under their management. The statewide inventory system reports and distributes information for all transactions that have not posted properly to the state inventory. These transaction registers are distributed regularly after each inventory period (i.e. quarterly) to be reviewed by the affected offices. The transactions must be corrected and submitted to ensure that the transactions are properly posted.

The department is also required to respond and reconcile on a quarterly basis, a DAGS-Inventory Management Branch Report called the Reconciliation of FAMIS Expenditures for State Property. This report requests verification that the department's FAMIS payment transactions for state properties are recorded in the DAGS, Fixed Asset Inventory System (FAIS). This statewide monitoring and reconciliation process was implemented to preserve the financial reporting integrity of the FAIS. As such, monitoring procedures are in place on a statewide basis.

In November 2005, a DHS memorandum, FMO Circular 05-05 was issued to clarify the responsibility of inventory reporting, due to instances of late or no inventory reporting because of the confusion as to who was responsible to place the equipment on inventory when 2 or more offices were involved.

The department uses the detailed procedures outlined in the DAGS Inventory System Manual and the Hawaii Administrative Rules (HAR) to provide instructions and guidelines for all DHS offices with inventory responsibilities. In addition, the department issues internal circulars and memorandums that serves to update any inventory changes, any changes to the HAR, and to provide clarification or information that is necessary for proper inventory reporting. The Inventory System Manual, the HAR, the FMO Circulars and memorandums all serve to provide guidelines and procedures for proper and timely inventory reporting. As such, all departmental personnel with inventory responsibilities are made

knowledgeable of the proper inventory procedures and reporting requirements to minimize any human/clerical errors and oversights.

The department has also provided inventory training in partnership with DAGS Inventory Management Branch and plans to conduct refresher training sessions. The State Procurement Office plans to conduct a series of inventory training sessions for the 2007 and 2008 calendar years. Department offices are also encouraged to consult with FMO-Property and Procurement Staff as necessary, whenever questions arise, thus providing "on-the-job" training.

Start Date: Ongoing  
End Date: Ongoing  
Responding Person: Susy Kawamoto, Property and Procurement Staff Supervisor,  
Fiscal Management Office (FMO)  
Phone: (808) 586-4864

**Ref. no. 06-2                      Maintain Vacation and Sick Leave Records Properly**

Auditor's Recommendation: We recognize that approvals of vacation could occur after the fact, such as when an employee must care for a dependent who becomes ill the night before. In those instances, we recommend that the employee's record be annotated to reflect that telephonic approval was given.

The DHS should increase the number of quality control reviews of leave records and perform them periodically throughout the year to ensure that vacation and sick leave and compensatory time records are accurately maintained and reviewed on a timely basis. The reviews should include ensuring that there is a secondary review performed on the leave records by the supervisor of the employee responsible for maintaining the records. In addition, a secondary review of the information used to prepare the summary leave schedule should be performed before compiling the schedule, including ensuring that the beginning balances are correct. These reviews should be documented with the initials of the employee responsible for performing the review.

Corrective Action Taken or Planned: DHS will continue to insure department procedures regarding the approval process of leave request are in compliance with appropriate collective bargaining unit agreements and policies and procedures.

DHS will continue random audits of leave records, training of staff personnel assigned the duties of maintaining the leave records, and training of supervisory personnel of leave records.

To improve the accuracy of the summary leave schedule, the Fiscal Management Office's Pre-Audit Staff will be randomly reviewing approximately 10% of the 2,000 employees. In

addition, a secondary review of approximately 200 employees will be performed to check the information obtained to compile the summary leave schedule, including ensuring that the beginning leave balances are correct.

Start Date: Ongoing

End Date: Ongoing

Responding Person: Edwin Nose, Personnel Officer  
Phone: (808) 586-4951  
Eloise Uehara, Pre-Audit Staff Supervisor, FMO  
Phone: (808) 586-5020

**Ref. no. 06-3**

**Allocate Costs Properly**

Auditor's  
Recommendation:

To ensure that the costs contained in the DHS's departmental cost allocation are allocated properly, the DHS should ensure that a secondary review is performed on all supporting cost allocation documents by the supervisor of the employee responsible for preparing the documents. This review should be documented with initials of the employee responsible for performing the review.

Corrective Action  
Taken or Planned:

In accordance with current procedures, the Administrative Appeals Officer (AAO) certifies the quarterly case count and the secretary manually calculates the allocation using AAO's internal logs. As additional measures, the supervisor will review the results and check for any discrepancies, such as comparing the results with that of the prior quarter(s) and checking for consistency or trends in the results. The secretary will also check the results. Efforts will continue to establish the internal logs as an electronic database so that the quarterly case counts do not need to be manually tabulated. The Department has amended the cost allocation claims for the quarter ending June 30, 2006 to correct the errors.

The Fiscal Management Office – Accounting Staff (FMO/ACCTG) will continue to review the cost allocation results for any discrepancies or anomalies, such as comparative analysis with prior quarters. If there are any significant discrepancies, FMO/ACCTG will notify the applicable DHS office of any necessary corrective actions.

Start Date: July 2007

End Date: Ongoing

Responding  
Person(s): Susan Wong, Administrative Appeals Officer  
Phone: (808) 586-5295  
Derek Oshiro, Chief Accountant, FMO  
Phone: (808) 586-5630

**Ref. no. 06-4**

**Improve the Accuracy of TANF Benefit Payments**

Auditor's  
Recommendation:

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the benefit payments being claimed for federal reimbursements. A secondary review would help to ensure that all required documents are properly completed and benefit payments are the correct amount.

Corrective Action  
Taken or Planned:

Written instruction will be provided to staff to remind staff that all required documents must be properly completed and maintained in each case record to support eligibility of benefits issued. A second review of cases does occur as the Quality Assurance Office reviews selected cases monthly, supervisors review cases monthly and when cases are transferred to and from another unit, and management evaluation teams review selected cases in selected units on an annual basis. A second review of all cases is prohibitive due to staffing.

Start Date:

July 2007

End Date:

Ongoing

Responding Person:

Sandra Morishige, Program Specialist, Benefit, Employment and Support Services Division (BESSD)  
Phone: (808) 586-5713

**Ref. no. 06-5**

**Maintain All Required Documentation in TANF Case Files**

Auditor's  
Recommendation:

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the benefit payments being claimed for federal reimbursements. A secondary review would help to ensure that all required documents are properly completed.

Corrective Action  
Taken or Planned:

Note that a TANF error was cited for no birth certificate for a client, but he is a non-needy spouse in the case so birth verification is not necessary for TANF. It may be considered an error for food stamps as he is a food stamp recipient.

Written instruction will be provided to staff to remind them that all required documents must be maintained in each case record to support eligibility of benefits issued. A second review of cases does occur as the Quality Assurance Office reviews selected cases monthly, supervisors review cases monthly and when cases are transferred to and from another unit, and management evaluation teams review selected cases in selected units on an annual basis. A second review of all cases is prohibitive due to staffing.

Start Date: July 2007  
End Date: Ongoing  
Responding Person: Sandra Morishige, Program Specialist, BESSD  
Phone: (808) 586-5713

**Ref. no. 06-6 Improve Utilization Controls over Medicaid Claims**

Auditor's Recommendation: DHS should obtain the necessary HPMMIS management reports to allow post payment review of recipient utilization and provider service profiles and exception criteria based on parameters set by the MQD.

Corrective Action Taken or Planned: HPMMIS management reports are in production and have been generated for review and use by MQD staff. The review process has resulted in requested modifications to some report's selection criteria and date parameters. The modifications are intended to increase the report's effectiveness and utility.

Discussions regarding the requirements for these modifications have been ongoing with MSB and SO. This will be an ongoing iterative process to make the management reports meaningful and useful.

Start Date: Ongoing  
End Date: Ongoing  
Responding Person: Randy Chau, Systems Officer, Med-QUEST Division (MQD)  
Phone: (808) 692-7951

**Ref. no. 06-7 Improve Accuracy of Medicaid Claims Processing**

Auditor's Recommendation: DHS should perform regular post payment reviews on a sample of claims to detect processing errors and identify ways to improve the claims processing system and procedures.

Corrective Action Taken or Planned: This response addresses correction plan for non-drug claims.

- The Medical Standards Branch, Compliance Unit is responsible for implementing a Surveillance and Utilization Review Subsystem (SURS). The goal of SURS is twofold:
  - 1) Surveillance: encompasses the process of monitoring the delivery and utilization of covered services and items by Medicaid recipients.
  - 2) Utilization review: involves the process of analyzing and evaluating the delivery and utilization of services and items with specific criteria.
- The Compliance Unit Nurses identified several computer system problems with regard to the extraction of post-payment review data. The problems and possible solutions

have been referred to the Systems Office for further technical assistance.

- The Compliance Unit Nurses are currently receiving quarterly reports from the Systems Office, which identify high-use services and items. The nurses have developed procedures to analyze the data for possible claims processing errors. The procedures include developing a database, which will assist in analyzing data and identifying possible trends.

Claims identified with errors may require referrals to the Compliance Unit Investigator, who will conduct on-site record reviews.

Start Date: Ongoing  
End Date: Ongoing  
Responding Person: Lois Lee, Acting Med-QUEST Division Administrator (A-MQDA)  
Phone: (808) 692-8050

**Ref. no. 06-8 Improve Controls over the Medicaid Drug Rebate Program**

Auditor's Recommendation: DHS should establish procedures to monitor their subcontractor to ensure rebate interest payments are collected and not disregarded as part of the dispute resolution process by either the manufacturer or the DHS.

Corrective Action Taken or Planned: DHS will work with ACS on establishing procedures on collecting rebate interest payments. DHS will also work in conjunction with the Attorney General's office in establishing a threshold of when payments may be disregarded or written off. Written procedures will be completed by October 31, 2007.

Start Date: May, 2005  
End Date: Ongoing  
Responding Person: Ann Kinningham, Finance Officer, MQD  
Phone: (808) 692-7956

**Ref. no. 06-9 Maintain All Required Documentation in Medicaid Case Files**

Auditor's Recommendation: DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the medical assistance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

Corrective Action Taken or Planned: The importance of properly completing and filing required departmental forms has been emphasized to Eligibility Branch Supervisors and Eligibility Workers.

Supervisory case reviews will include evaluation of proper

documentation and case record maintenance.

MQD believes that understaffing and the continued expansion of the Medical Assistance Program contributes to deficiencies in case record documentation and maintenance. Eligibility Branch will make efforts to fill vacancies expediently.

Start Date: Ongoing  
End Date: Ongoing  
Responding Person: Lois Lee, A-MQDA  
Phone: (808) 692-8050

**Ref. no. 06-10 Complete Medicaid Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner**

Auditor's Recommendation: DHS should assess the staffing needs at the Eligibility Branch and make every effort to ensure each unit is fully staffed with trained personnel in order to timely process applications and perform annual re-verifications. Adequate staffing would likely reduce the backlog of applications, pending eligibility determinations, and overdue annual re-verifications and also minimize the risk that ineligible recipients are receiving Medicaid benefits.

Corrective Action Taken or Planned: The Eligibility Branch will seek additional positions in the Biennium Budget to be addressed by the 2008 Legislature.  
The Eligibility Branch received ten additional eligibility worker positions that were approved by the 2005 Legislature. Position numbers have been assigned and are being recruited.  
All efforts will be made to expedite recruitment of vacancies within the Eligibility Branch. Recruitment efforts will be initiated immediately upon news of any anticipated vacancies.  
The Branch is: utilizing temporary 89-day appointments to fill vacant eligibility worker and clerical support positions, utilizing volunteer assistance from the BESSD/First To Work Program to assist with clerical support duties, and working with the Honolulu Community Action Program's Senior Community Service Employment Program to recruit seniors to work part-time in clerical support duties.

Start Date: Ongoing  
End Date: Ongoing  
Responding Person: Alan Takahashi, Eligibility Branch Administrator, MQD  
Phone: (808) 587-7291

**Ref. no. 06-11**

**Maintain All Required Medicaid Provider Documentation**

Auditor's  
Recommendation:

DHS should ensure all provider agreements are properly completed and maintained.

Corrective Action  
Taken or Planned:

The Department is in concurrence with the findings of the Single Audit report.

DHS has consolidated provider agreement documentation from our previous Fiscal Agent with DHS files to create one complete provider file. The agreements date back to as far back as the 1970's.

Because some of the providers initially began their relationship with the Medicaid program before some of the current required forms were in existence, there continues to be some gaps in documentation.

In 2006, a mass mailing to all providers was conducted to inform providers of the current uniform documentation requirements.

On an ongoing basis we also are requiring providers to update their provider agreements when they contact us to make changes to their provider profiles (i.e. address change, Tax ID change) and indicate the update in our database.

Provider agreements are sent to our new fiscal agent for imaging and can be easily accessed over the computer by those in MQD with access.

Start Date:

Ongoing

End Date:

Ongoing

Responding Person:

Lois Lee, A-MQDA  
Phone: (808) 692-8050

**Ref. no. 06-12**

**Implement Controls to Ensure the Medicaid Program is Credited Timely for Outstanding or Uncashed Checks**

Auditor's  
Recommendation:

DHS should implement controls to adequately monitor ACS's monthly bank reconciliations to properly credit the Medicaid program for checks that are outstanding or uncashed beyond 180 days of issuance.

Corrective Action  
Taken or Planned:

DHS has already implemented controls to return the funds for uncashed checks beyond 180 days of issuance. When the check reaches the 180 days, ACS will void the check and also void the claim associated with those checks. By voiding the claim in the HPMMIS, this triggers a credit amount which is then offset against the current payments which gets reported on the CMS-64 during that quarter.

Start Date: N/A  
End Date: Completed  
Responding Person: Ann Kinningham, Finance Officer, MQD  
Phone: (808) 692-7956

**Ref. no. 06-13      Improve the Accuracy of Medicaid Reports**

Auditor's Recommendation: DHS should ensure that complete and accurate information is submitted on the Medicaid Drug Rebate Schedule Form CMS 64.9R.

Corrective Action Taken or Planned: DHS is working on correcting the 64.9R to reflect the current invoiced amounts to the manufacturers. DHS will retroactively post the invoiced amounts to the correct quarter and also include the supplemental invoices that have not been posted. These adjustments will be reflected on the September 30, 2007 CMS-64.

Start Date: January 2005  
End Date: October 2007  
Responding Person: Ann Kinningham, Finance Officer, MQD  
Phone: (808) 692-7956

**Ref. no. 06-14      Maintain all Required Documentation in Adoption Assistance Case Files**

Auditor's Recommendation: DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the adoption assistance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

Corrective Action Taken or Planned: In July 2007, feedback regarding the missing documentation was given to supervisors of all cited units and they agreed to monitor the compliance with CWS policies and procedures more closely. The corresponding section administrators were also informed.  
  
The final results of the Title IV-E Adoption Assistance audit and recommendations made will be sent statewide to all section administrators reminding staff to maintain compliance with CWS policies and procedures and file documents in the CWS case record. Supervisors will be advised to conduct periodic Quality Assurance reviews of adoption cases to ensure that required documentation are on file and completed properly.

Start Date: July 2007  
End Date: Ongoing  
Responding Person: John Walters, Child Welfare Services – Program Development Administrator (CWS-PDA), Social Services Division (SSD)  
Phone: (808) 586-5675

**Ref. no. 06-15      Maintain all Required Documentation in Child Care Case Files**

Auditor's Recommendation: DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the child care payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

Corrective Action Taken or Planned: To correct this problem, DHS has taken the following actions:  
The Staff Development Staff (SDS) is continuing to train the Eligibility Workers on child care policies and procedures with emphasis on proper eligibility determination and maintenance of documentation in the case records. Since April 1, 2006 and on-going, the SDS has provided CC training with emphasis on maintenance of all required documentation in child care case files in April 2006 for eligibility workers, April and July 2006 for clerical staff, and May 2006 for First-to-Work (FTW) staff responsible for child care payments.

The Employment and Child Care Program (ECCP) staff has addressed the Supervisors, Section Administrators and Branch Administrators during the routine meetings about the importance of and need for maintaining all required documentation in child care case files. During these discussions ECCP staff has stressed the importance of maintenance of all required documentation in child care case files.

BESSD will be meeting in the near future with the Management Support Office (MSO), Quality Control (QC) staff to discuss a plan to conduct routine quarterly sample review of case files to determine if the problem cited above still exists.

The foregoing efforts should decrease clerical errors/oversight while authorizing child care payments in the future.

Start Date: April 2006  
End Date: Ongoing  
Responding Person: Mr. Scott Nakasone, Acting ECCP Administrator (A-ECCPA), BESSD  
Phone: (808) 586-7072

**Ref. no. 06-16**

**Identify Federal Award Information and Applicable Compliance Requirements to Child Care Subrecipients**

Auditor's  
Recommendation:

DHS should include the federal award information (e.g., CFDA title and number, award name, name of federal agency and amount of federal funds) and applicable compliance requirements in the subrecipient contracts to ensure Federal award information and applicable compliance requirements are identified to subrecipients at the time of the award.

Corrective Action  
Taken or Planned:

DHS will begin to implement the recommended action on all executed agreements that are effective July 1, 2007 and on-going.

Start Date:

July 2007

End Date:

Ongoing

Responding Person:

Mr. Scott Nakasone, A-ECCPA, BESSD  
Phone: (808) 586-7072

**Ref. no. 06-17**

**Improve Accuracy of Foster Care Maintenance Payments**

Auditor's  
Recommendation:

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed and foster care maintenance payments are the correct amount.

- 1 instance where a foster family was ineligible to receive maintenance payments because the foster family home was not fully licensed. This resulted in an overpayment of approximately \$9,989.

**SSD RESPONSE:**

The foster home met all of the licensing requirements. It was an oversight that a copy of the license was not in the case record. However, no one informed DHS during the audit that this was missing. Otherwise, it could have been provided to the auditor at that time. The home has been fully licensed and eligible for IV-E claims since April 2003. Therefore, there are no overpayments approximating \$9,989.00, as reported. Despite our request, the auditors did not revise this finding nor provide SSD with the specific dates as to what period the reported overpayments occurred.

Corrective Action  
Taken or Planned:

In July 2007, feedback regarding the missing documentation was given to supervisors of all affected units, and they agreed to monitor the compliance with CWS policies and procedures more closely. The corresponding section administrators were also informed.

The final results of the Title IV-E foster care audit and

recommendations made will be sent statewide to all section administrators reminding staff to maintain compliance with CSW policies and procedures and file documents in the CSW case record. Supervisors will be advised to conduct periodic Quality Assurance reviews of cases to ensure that required documentation are on file and completed properly. In addition, the DHS Management Information and Compliance (MIC) unit conducts periodic case reviews of Title IV-E eligible clients and their corresponding foster homes on an on-going basis.

Start Date: July 2007  
End Date: Ongoing  
Responding Person: John Walters, CWS-PDA, SSD  
Phone: (808) 586-5675

**Ref. no. 06-18**

**Maintain All Required Documentation in Foster Care Files**

Auditor's  
Recommendation:

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

- 4 instances where the foster family home was not fully licensed. The "Certificate of Approval" (Form DHS 1591B) was not effective while the child was in the care of the foster family.

**SSD RESPONSE:**

Regulations 42 USC 671(a) (10) and USC 672(c) only require that the home be fully licensed in order to receive IV-E foster care maintenance funds. If the state provisionally licenses a foster home and pays maintenance with strictly state funds, the Department is still in compliance with federal regulations, and Hawaii regulations allow for provisional licensing per HAR § 17-890-5(e).

Although these homes were not fully licensed, they were provisionally licensed (Form DHS 1586), and were in the process of full licensure. When a foster home is only provisionally licensed, the Department does not claim Title IV-E funds in accordance with the federal regulations, as was the case for these 4 examples cited.

Corrective Action  
Taken or Planned:

In July 2007, feedback regarding the missing licensing documentation was given to supervisors of the affected units, and they agreed to monitor the compliance with licensing procedures more closely. The corresponding section administrators were also informed.

The final results of the Title IV-E Foster Care audit and recommendations made will be sent statewide to all section

administrators reminding staff to maintain compliance with policies and procedures and to file required documents in the case record. Licensing supervisors will be advised to conduct periodic Quality Assurance reviews of cases to ensure that required documentation are on file. In addition, the DHS Management Information and Compliance (MIC) unit conducts periodic case reviews of Title IV-E eligible clients and their corresponding foster homes on an ongoing basis.

Start Date: July 2007  
End Date: Ongoing  
Responding Person: John Walters, CWS-PDA, SSD  
Phone: (808) 586-5675

**Ref. no. 06-19                      Improve Controls Over Foster Care Disbursements**

Auditor's Recommendation: We recommend that program staff reevaluate existing policies and procedures to ensure that program expenditures are allowed and charged to the proper program.

**SSD RESPONSE:** A check into the CPSS indicated that this service was provided using special state funds from the Wrap-around or CAN emergency funds, **not** federal foster care funds.

Such assistance for the parent, including security deposits or rent, is appropriate and allowable under the wrap/CAN emergency funds since the two children were in the process of reunification with their mother.

Despite SSD's request, the auditors did not provide any documentation substantiating that this service was in fact charged inappropriately to foster care funds.

Corrective Action Taken or Planned: N/A  
The federal Title IV-E audit of 80 clients conducted in June 2007 found no such error payments for which ineligible types of services (i.e. not related to foster care maintenance costs) were paid using federal IV-E monies.

Start Date: N/A  
End Date: N/A  
Responding Person: John Walters, CWS-PDA, SSD  
Phone: (808) 586-5675

**Ref. no. 06-20                      Monitor Social Services Block Grant Earmarking Requirements**

Auditor's Recommendation: We recommend that the program evaluate and modify these agreements to include a requirement to provide programs or services to children or families that meet federal poverty guidelines in order to comply with earmarking requirements. In

addition, we recommend that the program implement monitoring procedures and reporting requirements to ensure each contractor is in compliance with earmarking requirements.

Corrective Action  
Taken or Planned:

We will review our allocation of funds to ensure that SSBG/TANF funds are proportionately directed towards the eligible client population.

However, we believe that our current methodology for assessing client eligibility is accurate and sufficient, since it is based on the same eligibility determination process and data collection that establishes the percentage of AFDC-related children in foster care. This method reasonably reflects the overall economic characteristics of children and families served by Child Welfare Services (CWS).

Based on our ongoing case reviews, approximately 70% of the children in CWS foster care come from families who currently meet the 1996 AFDC income limits. For example the 1996 AFDC income limit for a family of 3 is \$2109. This compares to the 2007 "200% of poverty standard of \$3,291 for a family of 3.

Start Date:

N/A

End Date:

N/A

Responding Person:

John Walters, CWS-PDA, SSD  
Phone: (808) 586-5675

**Ref. no. 06-21**

**Maintain All Required Documentation in SCHIP Case Files**

Auditor's  
Recommendation:

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the eligibility of individuals who receive child health assistance. A secondary review would help to ensure all required documents are properly completed.

Corrective Action  
Taken or Planned:

The importance of properly completing and filing required departmental forms has been emphasized to Eligibility Branch Supervisors and Eligibility Workers.

Supervisory case reviews will include evaluation of proper documentation and case record maintenance.

MQD believes that understaffing and the continued expansion of the Medical Assistance Program contribute to deficiencies in case record documentation and maintenance. Eligibility Branch will make efforts to fill vacancies expediently.

Start Date:

July 2007

End Date:

Ongoing

Responding Person:

Lois Lee, A-MQDA  
Phone: (808) 692-8050

**Ref. no. 06-22**

**Identify Federal Award Information and Applicable Compliance Requirements to Food Stamp Subrecipients**

Auditor's  
Recommendation:

DHS should include the federal award information (e.g., CFDA title and number, award name, name of federal agency and amount of federal funds) and applicable compliance requirements in the subrecipient contracts to ensure Federal award information and applicable compliance requirements are identified to subrecipients at the time of the award.

Corrective Action  
Taken or Planned:

DHS will begin to implement the recommended action on all executed agreements that are effective July 1, 2007 and on-going.

Start Date:

July 2007

End Date:

Ongoing

Responding Person:

Mr. Scott Nakasone, A-ECCPA, BESSD  
Phone: (808) 586-7072

**Ref. no. 06-23**

**Maintain Adequate Security over EBT Cards**

Auditor's  
Recommendation:

We recommend that program adhere to the policies and procedures for maintaining adequate security over EBT cards to prevent loss or theft.

Corrective Action  
Taken or Planned:

During the period from September 2006 through March 2007, all units were reminded of the requirement to maintain security over their EBT cards during their Sections' supervisory meetings on Oahu and via e-mail to the neighbor island supervisors.

As required by the Food Stamp Program's management evaluation (ME) requirements, the EBT office will continue to monitor the units' Bulk EBT Card Inventory Logs, Daily Issuance logs and the audits conducted by the unit supervisors for the units that are selected for the annual EBT ME reviews.

Start Date:

September 2006

End Date:

Ongoing

Responding Person:

Wayne Akizaki, Project Manager, EBT Project, BESSD  
Phone: (808) 586-5739